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# The Unfinished Business of Dodd-Frank: Reforming the Mortgage Contract

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# THE UNFINISHED BUSINESS OF DODD-FRANK: REFORMING THE MORTGAGE CONTRACT

Christopher K. Odinet\*

## ABSTRACT

*The standard residential mortgage contract is due for a reappraisal in light of today's mortgage lending and regulatory environment. The goals of Dodd-Frank and the Consumer Financial Protection Bureau have been geared toward creating better stability in the residential mortgage market, in part, by mandating more robust underwriting. This is achieved chiefly through the ability-to-repay rules and the "qualified mortgage" safe harbor, which call for very conservative underwriting criteria to be applied to new mortgage loans. Lenders are whole-heartedly embracing these criteria in their loan originations—in the fourth quarter of 2015 over 98% of all new residential loans were qualified mortgages, thus resulting in a new wave of homeowners that are less likely than ever before to default. As a result, the standard form residential mortgage contract, with its harsh terms and overreaching provisions in favor of the lender, should be reformed. This is necessary not only due to the fact that such terms should no longer be needed since borrowers are better financially positioned than in the past, but also because of a disturbing trend in the past few years where lenders and their third party contractors have abused the powers accorded to them by the mortgage contract—mostly through break-in style foreclosures. This Article argues for a reformation of the standard residential mortgage contract and specifically singles out three common provisions that are ripe for modification or removal.*

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## INTRODUCTION

THERE'S no place like home.<sup>1</sup> Indeed, the dream of homeownership has been, and continues to be, a cornerstone of American law and policy making.<sup>2</sup> For instance, the law accords homeowners a host of rights when it comes to criminal liability, damages in tort, tax treatment, property law-based protections, and constitutional guarantees.<sup>3</sup> Moreover, policymakers focus on homeownership as a way to advance social and economic goals.<sup>4</sup> Purchasing a home is encouraged by public spending on federal and state programs that seek to open credit

1. NOEL LANGLEY, FLORENCE RYERSON & EDGAR ALLEN WOLF, *THE WIZARD OF OZ* 148 (Metro-Goldwyn-Mayer 1939 (based on L. FRANK BAUM, *THE WONDERFUL WIZARD OF OZ* (1900); JOHN HOWARD PAYNE, *CLARI: OR, THE MAID OF MILAN* 8 (1823))).

2. CHASING THE AMERICAN DREAM: NEW PERSPECTIVES ON AFFORDABLE HOMEOWNERSHIP (William M. Rohe & Harry L. Watson eds., Cornell Univ. Press 2007); JOHAN NORBERG, *FINANCIAL FIASCO: HOW AMERICA'S INFATUATION WITH HOMEOWNERSHIP AND EASY MONEY CREATED THE ECONOMIC CRISIS* (Cato Inst. 2009).

3. See *infra* Part I.B. and accompanying discussion.

4. See ERIC S. BELSKY, *THE DREAM LIVES ON: THE FUTURE OF HOMEOWNERSHIP IN AMERICA* 13-15 (Joint Center for Housing Studies, Harvard Univ. 2013), [http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/w13-1\\_belsky\\_0.pdf](http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/w13-1_belsky_0.pdf) [<http://perma.cc/928M-M76C>].

markets to would-be borrowers.<sup>5</sup> Municipal planning exercises are focused on engineering livable spaces and creating strategically zoned buffers to ensure residential areas are protected from other uses,<sup>6</sup> while large enterprises backed by the credit of the United States government have been formed for the sole purpose of promoting homeownership.<sup>7</sup> And in the wake of natural disasters, government spending and policy rhetoric focuses on rebuilding and bringing people back “home.”<sup>8</sup> In fact, America’s entire economic and political history is rife with examples of “[p]ublic interventions in the housing market” based on the notion that good housing policy stands for good public policy overall.<sup>9</sup>

Moreover, it is not only law and policy that favor homeownership, but society and popular culture as well. Notions of success and images of independence and achievement are acutely focused on homeownership. Proponents assert that those who own their homes have a propensity to be more invested in their communities and, thus, better citizens.<sup>10</sup> From an economic perspective, equity in one’s home is espoused as being the safest and most certain way to transmit wealth from one generation to the next.<sup>11</sup> The purchase of a home is viewed as a good investment and as a corollary to income success.<sup>12</sup> Ownership of one’s home is lauded as being the best adjunct to the successful rearing of children, the maintenance

5. See ALEX F. SCHWARTZ, *HOUSING POLICY IN THE UNITED STATES* 7 (3d ed. 2014); see also MARTIN NEIL BAILY, *THE FUTURE OF HOUSING FINANCE: RESTRUCTURING THE U.S. RESIDENTIAL MORTGAGE MARKET* (Brookings Inst. Press 2011).

6. JOHN R. NOLON & PATRICIA E. SALKIN, *LAND USE AND SUSTAINABLE DEVELOPMENT LAW: CASES AND MATERIALS* 59 (8th ed. 2012); Matthew L. McGinnis, Note, *Sex, But Not the City: Adult-Entertainment Zoning, the First Amendment, and Residential and Rural Municipalities*, 46 B.C. L. REV. 625, 626–27 (2005); Katharine B. Silbaugh, *Women’s Place: Urban Planning, Housing Design, and Work-Family Balance*, 76 FORDHAM L. REV. 1797, 1818–21, 1823–25 (2007).

7. Nathan A. Hertzog, *VII. Regulatory Future of Fannie Mae and Freddie Mac*, 31 REV. BANKING & FIN. L. 62, 64–68 (2011); Kate Pickert, *A Brief History of Fannie Mae and Freddie Mac*, TIME (July 14, 2008), <http://content.time.com/time/business/article/0,8599,1822766,00.html> [<http://perma.cc/J7LW-PFHY>]; VIRAL V. ACHARYA ET AL., *GUARANTEED TO FAIL: FANNIE MAE, FREDDIE MAC AND THE DEBACLE OF MORTGAGE FINANCE* 7, 14–15, 27–28 (Princeton Univ. Press 2011); see also generally OONAGH McDONALD, *FANNIE MAE AND FREDDIE MAC: TURNING THE AMERICAN DREAM INTO A NIGHTMARE* (Bloomsbury Acad. 2012); CONG. BUDGET OFFICE, *FANNIE MAE, FREDDIE MAC, AND THE FEDERAL ROLE IN THE SECONDARY MORTGAGE MARKET VIII* (2010).

8. See e.g., William P. Quigley, *Obstacle to Opportunity: Housing that Working and Poor People Can Afford in New Orleans Since Katrina*, 42 WAKE FOREST L. REV. 393, 394–96, 408–14 (2007); Edward P. Stringham & Nicholas A. Snow, *The Broken Trailer Fallacy: The Disaster of Post-Katrina Housing Policies*, 36-SUM ADMIN. & REG. L. NEWS 8, 8 (2011).

9. ANNE B. SHLAY, *Low-Income Homeownership: American Dream or Delusion?*, in 43 URBAN STUDIES, 511, 512 (Routledge 2006).

10. MICHAEL COLLINS, *MILLENNIAL HOUSING COMM’N, PURSUING THE AMERICAN DREAM: HOMEOWNERSHIP AND THE ROLE OF FEDERAL HOUSING POLICY* 3, 5 (Jan. 2002), <http://govinfo.library.unt.edu/mhc/papers/collins.pdf> [<https://perma.cc/2FYN-5YYM>].

11. See Shlay, *supra* note 9, at 513 (citing E. S. Belsky & M. Duda, *Asset appreciation, timing of purchases, and sales, and returns to low-income homeownership*, in *LOW-INCOME HOMEOWNERSHIP: EXAMINING THE UNEXAMINED GOAL* 208–38 (N.P. Retsinas & E.S. Belsky eds., Brookings Inst. 2002)).

12. See Michal Grinstein-Weiss & Clinton Key, *Homeownership, the Great Recession, and Wealth: Evidence from the Survey of Consumer Finance*, in 25 HOUS. POL’Y DEBATE

of good health, and the building of a secure social network.<sup>13</sup> And Americans have certainly taken this information to heart. In the second quarter of 2015 alone, nearly 64% of all Americans owned their home, with such purchases representing their largest asset and most significant source of personal wealth.<sup>14</sup> Indeed, society often cites the proverb of a man and his castle to harken to mind a sense of dignity, autonomy, and strength.<sup>15</sup>

However, in the decades leading up to 2008, a system of financial greed and poor policy-making did great harm to homeownership in America.<sup>16</sup> The low-to-no underwriting standards that led to the rise of subprime loans, combined with the sudden drop in the value of properties when the housing bubble burst, resulted in massive defaults and a foreclosure crisis that rocked the housing market.<sup>17</sup> Moreover, with the advent of securitization, these toxic assets came to infect the much larger economy and resulted in massive layoffs, the stock market plummeting, and the destabilization of household financial security across the United States.<sup>18</sup> As a result, “American households saw the value of residential real estate fall by over \$4 trillion in 2007 and 2008, in addition to a decline in the total value of US stocks of approximately \$8 trillion in 2008 alone.”<sup>19</sup> The crash was particularly hard on minorities; between 2005 and 2009 home-

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419 (2015), [https://www.stlouisfed.org/~media/Files/PDFs/HFS/20130205/papers/GrinsteinWeiss\\_paper.pdf](https://www.stlouisfed.org/~media/Files/PDFs/HFS/20130205/papers/GrinsteinWeiss_paper.pdf) [https://perma.cc/WFC5-YJ7D].

13. *Id.*

14. *Homeownership Rates by Region*, U.S. CENSUS, <http://www.census.gov/housing/hvs/files/qtr215/hown215.png> [https://perma.cc/L3E8-6XTV] (last visited Sept. 4, 2015); Zhu Xiao Di, Eric Belsky & Xiaodong Liu, *Do Homeowners Achieve More Household Wealth in the Long Run?*, 16 J. OF HOUSING ECON. 274–90 (2007).

15. Christopher Hitchens, *A Man's Home Is His Constitutional Castle*, SLATE (July 27, 2009), [http://www.slate.com/articles/news\\_and\\_politics/fighting\\_words/2009/07/a\\_mans\\_home\\_is\\_his\\_constitutional\\_castle.html](http://www.slate.com/articles/news_and_politics/fighting_words/2009/07/a_mans_home_is_his_constitutional_castle.html) [https://perma.cc/VS87-8TGZ]; 4 WILLIAM BLACKSTONE, COMMENTARIES (Lewis ed., 1922), Lonang Inst., <http://lonang.com/library/reference/blackstone-commentaries-law-england/bla-416/> [https://perma.cc/66RD-8TFE] (“[a]nd the law of England has so particular and tender a regard to the immunity of a man's house, that it stiles it his castle, and will never suffer it to be violated with impunity . . .”).

16. Joseph William Singer, *Foreclosure and the Failures of Formality, or Subprime Mortgage Conundrums and How to Fix Them*, 46 CONN. L. REV. 497, 500 (2013); Christopher K. Odinet, *Banks, Break-ins, and Bad Actors in Mortgage Foreclosure*, 83 U. CIN. L. REV. 1155, 1163–66 (2015).

17. Adam J. Levitin, *Resolving the Foreclosure Crisis: Modification of Mortgages in Bankruptcy*, 2009 WIS. L. REV. 565, 566–67 (2009); Gregg H. Mosson, *Robosigning Foreclosures: How it Violates Law, Must be Stopped, and Why Mortgage Law Reform is Needed to Ensure the Certainty and Values of Real Property*, 40 W. ST. U. L. REV. 31, 34–44 & n.36 (2012); Tami Luhby, *Robo-signing: Just the Start of Bigger Problems*, CNN MONEY.COM (Oct. 22, 2010, 7:38 AM), [http://money.cnn.com/2010/10/22/real\\_estate/foreclosure\\_paper\\_work\\_problems/](http://money.cnn.com/2010/10/22/real_estate/foreclosure_paper_work_problems/) [https://perma.cc/QNE5-9SVU]; Christopher L. Peterson, *Predatory Structured Finance*, 28 CARDOZO L. REV. 2185, 2188–90 (2007); Christopher L. Peterson, *Foreclosure, Subprime Mortgage Lending, and the Mortgage Electronic Registration System*, 78 U. CIN. L. REV. 1359, 1360 (2010).

18. See Odinet, *supra* note 16, at 1163–66 (discussing mortgage loan securitization and the dissemination of collateral-based mortgage securities throughout the economy, such as to pension funds as well as investment banks and related financial institutions).

19. ANAT BRACHA & JULIAN C. JAMISON, SHIFTING CONFIDENCE IN HOME OWNERSHIP: THE GREAT RECESSION, FED. RES. BANK OF BOSTON 2 (2011), [http://www.bostonfed.org/economic/conf/LTE2011/papers/bracha\\_jamison.pdf](http://www.bostonfed.org/economic/conf/LTE2011/papers/bracha_jamison.pdf) [https://perma.cc/7END-U48Z].

ownership rates dropped for African Americans and Hispanics.<sup>20</sup>

In response, Congress passed a series of acts to bring order and balance to the housing market and the related financial system by reforming the ways in which home loans are originated and administered.<sup>21</sup> The most significant of these measures was the Dodd-Frank Act and the related Consumer Financial Protection Bureau that it created, both of which are geared toward creating better stability in the residential mortgage market, in part, by mandating and enforcing robust underwriting by lenders.<sup>22</sup> A number of advocates and commentators have noted that these measures might result in a further tightening of credit, thereby shutting out many Americans from the dream of homeownership.<sup>23</sup> While it is still

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20. *Recession Widens Racial Homeownership Gap*, INST. OF GOVERNMENTAL STUDIES, U. CAL. BERKELEY (Sept. 15, 2011), <http://brr.berkeley.edu/2011/09/recession-widens-racial-homeownership-gap/> [https://perma.cc/7WNP-6KMB].

21. Alan S. Kaplinsky, *CFPB Announces 2013 Regulatory Agenda*, 66 CONSUMER FIN. L.Q. REP. 418, 404 (2012); STEVE FORRY, *The CFPB in review: a healthy dose of enforcement and a dash of setting boundaries*, in BANKING & FIN. SERVICES POL'Y REP. (Oct. 2013), <http://bi.galegroup.com.proxy.libraries.smu.edu/global/article/GALE%7CA347431997/0705d0aa0018ec07b77f88e67c5483d8?u=txshracd2548> [https://perma.cc/X62F-AQAM]; Jean Eaglesham, *Warning Shot On Financial Protection*, WALL ST. J. (Feb. 9, 2011), <http://www.wsj.com/articles/SB10001424052748703507804576130370862263258> [https://perma.cc/QUM6-M848].

22. Adam J. Levitin, Andrey D. Pavlov & Susan M. Wachter, *The Dodd-Frank Act and Housing Finance: Can it Restore Private Risk Capital to the Securitization Market?*, 29 YALE J. ON REG. 155, 157–58 (2012); Arthur E. Wilmarth, Jr., *The Dodd-Frank Act: A Flawed and Inadequate Response to the Too-Big-to-Fail Problem*, 89 OR. L. REV. 951, 953–54 (2011).

23. Jonathan Weisman & Eric Lipton, *In New Congress, Wall St. Pushes to Undermine Dodd-Frank Reform*, N.Y. TIMES (Jan. 13, 2015), [http://www.nytimes.com/2015/01/14/business/economy/in-new-congress-wall-st-pushes-to-undermine-dodd-frank-reform.html?\\_r=0](http://www.nytimes.com/2015/01/14/business/economy/in-new-congress-wall-st-pushes-to-undermine-dodd-frank-reform.html?_r=0) [https://perma.cc/G5UD-G3JE] (“As of Nov. 16, Wall Street banks and other financial interests had spent \$1.2 billion on campaign contributions and lobbying combined, a total that was on track to beat spending in 2010, when Dodd-Frank was being considered in Congress, according to Americans for Financial Reform.”); Blaine Luetkemeyer, *Opposing view: CFPB is hurting customers, not helping*, USA TODAY (October 7, 2012), <http://www.usatoday.com/story/opinion/2012/10/07/cfpb-credit-obama-consumers/1618493/> [https://perma.cc/NDZ6-XN2S]; *CUNA to Congress: CFPB hurting consumers, structural changes necessary*, CREDIT UNION INSIGHT (July 15, 2015), <https://www.cuinsight.com/press-release/cuna-to-congress-cfpb-hurting-consumers-structural-changes-necessary> [https://perma.cc/N9PM-BKHH]; Sean Hackbarth, *Why CFPB's Complaint Database is a Bad Idea*, U.S. CHAMBER OF COM. (Aug. 22, 2014), <https://www.uschamber.com/above-the-fold/why-cfpb-s-complaint-database-bad-idea> [https://perma.cc/DWP8-J74T]; *Opaque Obama And His Rogue Credit Agency*, INVESTOR'S BUS. DAILY (April 2, 2014), <http://www.investors.com/politics/editorials/rogue-cfpb-bars-republican-lawmaker-duffy-from-secret-meeting/> [https://perma.cc/R94U-V6QM]; Jack Milligan, *What is Good, and Bad, About the CFPB*, BANKDIRECTOR.COM (April 20, 2012), <http://www.bankdirector.com/magazine/archives/2nd-quarter-2012/what-is-good-and-bad-about-the-cfpb/> [https://perma.cc/2539-LGB2] (“My concern is that banks will end up being subjected to a level of scrutiny—and interference—by an activist CFPB that is disproportionate to their shortcomings on consumer issues. It's not that every bank is perfect, but this industry's record for consumer fairness is better than most. Will more intense scrutiny on product design, marketing and distribution drive up the industry's costs without yielding a concomitant gain to consumers? Will tougher regulation on consumer compliance have a chilling effect on innovation?”); Edward Wyatt, *A Scale-Back Is Possible in Financial Overhaul Law*, N.Y. TIMES (Nov. 3, 2010), <http://www.nytimes.com/2010/11/04/business/04regulation.html?mtrref=topics.nytimes.com&gwh=79001D21883A54A1F8EBDA12522CC2B3&gwt=pay> [https://perma.cc/VW2W-HE8Q].

too early to tell how true this prediction may be, these financial reforms, by their very nature, are meant to lead to a class of more creditworthy, solvent, and reliably non-defaulting borrowers—"super borrowers"—thereby warding off (so the argument goes) a future housing crisis. In fact, the latest data shows that lenders are dutifully conforming to these underwriting limitations in almost all new loan originations.<sup>24</sup>

From this data, one can conclude that borrowers for whom home loan credit is now being advanced are more likely than in the past to meet their financial obligations over the life of the loan.<sup>25</sup> This is due to the fact that these borrowers must meet not only the generalized "ability to repay" requirements that Dodd-Frank imposes upon all mortgage lenders,<sup>26</sup> but data suggests that due to risk aversion lenders are opting to almost exclusively make loans that conform to the heightened standards of the "qualified mortgage" rubric in order to make use of safe harbor protections.<sup>27</sup>

But for all of the many protections and benefits that U.S. law and policy provide homeowners, one area that is decidedly anti-homeowner is the modern residential mortgage contract. Lenders have long imposed one-sided, burdensome, and often harsh terms on their borrowers through the mortgage contract in order to mitigate their risk of loss in the event of a default.<sup>28</sup> These terms provide everything from control over payments the owner is obligated to make to third parties in connection with the property, to the outright usurpation of possession and control of the property in certain instances.<sup>29</sup>

But while these provisions might have been in some sense justified at a time when credit was being given to anyone who asked for it, the world of financial underwriting has greatly changed since 2010. Since lenders are

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24. Commentary, *U.S. Residential Mortgage Servicing Mid-Year Review and 2015 Outlook*, DBRS.COM 1, 3 (2015), <http://www.dbrs.com/industries/bucket/id/10045/name/commentaries/page/3> [https://perma.cc/ZS6V] (follow "U.S. Residential Mortgage Servicing Mid-Year Review and 2015 Outlook" hyperlink) [hereinafter *DBRS Mortgage Report*].

25. See *id.* at 8 (discussing the low-risk attributes that lenders are requiring for borrowers who fail to meet the stringent requirements to be eligible for the "qualified mortgage" loan).

26. Elizabeth L. McKeen, Trevor Lain & Dixie Noonan, *Mortgage Underwriting: The Qualified Mortgage and Ability to Repay Rules*, 129 BANKING L.J. 826, 826 (2012) (discussing the factors that mortgage originators must use in analyzing a borrower's loan application, as well as the safe harbor that deems a borrower to be in good faith if the loan and the borrower have certain low-risk terms and attributes).

27. See *DBRS Mortgage Report*, *supra* note 24, at 9 ("DBRS expects that most lenders who are still recovering from the massive fines they had to pay for making subprime loans will not be originating anything but QM loans in 2015 unless it is in an effort to accommodate a customer with significant liquid assets. As a result, DBRS expects the availability of credit to continue to be constrained in 2015 for borrowers with blemished credit and a limited amount of cash reserves.").

28. See Odinet, *supra* note 16, at 1180–85; see also Katherine Porter & Tara Twomey, *Risk Allocation in Homeownership: Revisiting the Role of Mortgage Contract Terms*, in SHARED RESPONSIBILITY, SHARED RISK 142–60 (Jacob Hacker & Ann O'Leary eds., 2012).

29. See Odinet, *supra* note 16, at 1180–84 (describing the terms of the standard residential mortgage promulgated by the GSEs).

now disincentivized from making loans to “risky” borrowers—with the latest reports showing that lenders are choosing to advance credit only to the most creditworthy of individuals<sup>30</sup>—the overreaching provisions that have become such a hallmark of mortgage contracts in the United States are, in many cases, no longer needed and should be greatly curtailed, with some being completely removed.<sup>31</sup> Such provisions include, among others, the mandatory escrow requirements for various reoccurring expenses such as property taxes and insurance; the lender’s unilateral right to enter the premises for inspections and to conduct maintenance and repairs; and the broad authorizations that borrowers grant to lenders in the event of any form of default, all prior to foreclosure.<sup>32</sup> Thus, the rise of the new super borrower greatly alleviates the need to maintain many aspects of the standardized residential mortgage contract as we know it today, and, instead, provides an opportunity to align mortgage contracts with broader policy choices regarding homeownership.

This Article argues that if would-be homeowners must now undergo such stringent credit scrutiny and pass through such an arduous gauntlet of underwriting, the legal relationship between the borrower and the lender should—like so many other areas of the law that focus on the promotion and integrity of homeownership—accord the property owner more autonomy and dignity in his home. Part I puts this notion in context by discussing the rise and the importance of the standardized residential mortgage contract.<sup>33</sup> Part II then focuses on the modern mortgagor-mortgagee relationship through the lens of the development of the standard residential mortgage contract by discussing housing finance—both the public and private side of these transactions—and continues by providing an overview of the financial crisis of 2008 and the legal and regulatory response that followed it.<sup>34</sup> This part also explains the new strict underwriting requirements brought about by the Dodd-Frank Act under the creation and supervision of the Consumer Financial Protection Bureau.<sup>35</sup> Part III then places the legal juxtaposition between the rights of homeowners and mortgage lenders in context by arguing for the modification or elimination of certain clauses found in standard residential mortgage contracts by emphasizing the ways in which they nearly eviscerate the dignity society affords homeownership, how the law attaches to homeownership, and how those laws attempt to broadly impinge upon or abrogate the rights of the owner.<sup>36</sup> Part III concludes by recommending changes to three provisions in the mortgage contract that either provide the most opportunities for abuse or diminish the autonomy of the

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30. See DBRS Mortgage Report, *supra* note 24, at 8.

31. See *infra* Part III.B.

32. See *infra* Part III.B.

33. See *infra* Part I.

34. See *infra* Part II.

35. See *id.*

36. See *infra* Part III.



owner.<sup>37</sup> In conclusion, by making such reforms, the mortgage contract will come to better reflect our broader policy choices about homeownership, as well as uphold the status of the borrower as the owner of his home—his castle.

## I. THE RESIDENTIAL MORTGAGE CONTRACT

The uniform residential mortgage contract is the cornerstone of American housing finance.<sup>38</sup> Indeed, widespread homeownership throughout this country would hardly be possible without it.<sup>39</sup> This all-important instrument helps facilitate the flow of housing credit across the country and provides access to the resources necessary for many Americans to own their homes.<sup>40</sup>

### A. FANNIE MAE, FREDDIE MAC, AND THE FHA

While the government has always had a hand in housing, the Federal Housing Administration (FHA), an agency within the U.S. Department of Housing and Urban Development (HUD), has played perhaps the most significant role—and this is certainly true when it comes to the uniform residential mortgage contract.<sup>41</sup> The FHA can be best conceptualized as “a specialized insurance company that guarantees the payment of mortgages made by private lenders (banks and other mortgage lenders) who provide loans to developers and homebuyers.”<sup>42</sup> The FHA was formed in 1934 shortly after the Great Depression when mortgage loans were not easy to come by.<sup>43</sup> Loan-to-value ratios around 50-60% and large balloon payments were a hallmark of many mortgage loans at the time.<sup>44</sup> The FHA’s mission, however, was to bring reform and fresh air to the housing finance structure in America.<sup>45</sup> In meeting this goal, it helped usher in mortgage loans that had longer repayment terms and required a very low down payment.<sup>46</sup> But for purposes of this Article, the most important thing the FHA did was lower the credit risk to private lenders by providing insurance on the mortgage loans originated with borrower-favorable terms.<sup>47</sup> A private lender could advance credit without the need to be overly concerned that the borrower might default, and there-

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37. *See id.*

38. *See* Julia Patterson Forrester, *Fannie Mae/Freddie Mac Uniform Mortgage Instruments: The Forgotten Benefit to Homeowners*, 72 MO. L. REV. 1077, 1078–80 (2007).

39. *See id.* at 1078.

40. *See id.*

41. *Id.* at 1081.

42. *See* David J. Reiss, *Underwriting Sustainable Homeownership: The Federal Housing Administration and the Low Down Payment Loan*, BROOK. L.S. LEGAL STUDIES PAPER NO. 420, (citing MGMT. REPORT FISCAL YEAR 2007, U.S. FED HOUS. ADMIN. 3 (2007), <http://www.hud.gov/offices/hsg/fhfy07annualmanagementreport.pdf> [<https://perma.cc/NH7H-ZQ9Z>]).

43. *See id.*

44. *Id.* at 15.

45. *Id.* at 16.

46. *Id.*

47. *Id.* at 17.

fore cause the bank a loss.<sup>48</sup> Instead, the FHA would issue a mortgage insurance policy that would protect the private lender from bearing the economic brunt of the default.<sup>49</sup>

Use of FHA loans were very popular for most borrowers.<sup>50</sup> Taking out such a loan with a private lender permitted the borrower to put down a smaller down payment than would otherwise be required under the lender's conventional underwriting standards; weak or low credit scores did not serve as a disqualifier, insubstantial employment or income levels were allowable, and a higher debt to value ratio was sanctioned with an FHA loan.<sup>51</sup>

Importantly, however, the FHA heralded the arrival of the secondary mortgage market.<sup>52</sup> Since an FHA-backed mortgage loan carried with it a government guarantee, lenders who originated mortgages could easily sell the loans to other lenders and financial institutions for an immediate return.<sup>53</sup> To provide a ready group of buyers of such loans (and thereby increase bank liquidity for purposes of making additional mortgage loans), over time the government created special entities called Fannie Mae, Freddie Mac, and Ginnie Mae to purchase these loans and provide more liquidity to the mortgage market—thus expanding credit further.<sup>54</sup>

Fannie Mae and Freddie Mac (chartered in 1930 and 1970, respectively)—the so-called government-sponsored entities (GSEs)—are the most powerful of the three entities when it comes to housing economics.<sup>55</sup> These companies, created by Congress, are mandated to expand the availability of mortgage credit in the U.S., specifically by aiming to service certain income groups, while at the same time operating like a private company (in other words, with an aim toward profits and increasing shareholder value).<sup>56</sup> Through their mortgage purchasing and securitization activities over the years they have become the largest and most substantial generator of homebuyer credit in the U.S.<sup>57</sup>

## B. THE MOVE TOWARD STANDARDIZATION

As Forrester and Carozzo note in their work on the standard residential mortgage, uniformity of documents in the housing finance world was

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48. See Reiss, *supra* note 42, at 17.

49. *Id.*

50. See *id.* at 18.

51. See *id.* at 22–23.

52. See *id.* at 17.

53. See *id.* at 18.

54. See Reiss, *supra* note 42, at 17–18.

55. See *id.* at 17 (“To advance [mortgage credit] even further, the federal government created Fannie Mae in 1938 to create a secondary market for FHA mortgages. Fannie Mae spun off Ginnie Mae in 1968 to securitize FHA mortgages while Fannie securitized mortgages that were not insured by the federal government.”).

56. David Reiss, *Fannie Mae and Freddie Mac and the Future of Federal Housing Finance Policy: A Study of Regulatory Privilege*, 61 ALA. L. REV. 907, 908–10 (2010) [hereinafter *FHA*].

57. See Julia Patterson Forrester, *Fannie Mae/Freddie Mac Uniform Mortgage Instrument: The Forgotten Benefit to Homeowners*, 72 MO. L. REV. 1077, 1082 (2007).

quite unheard of prior to 1970.<sup>58</sup> Despite attempts by large financial institutions operating in various states, as well as professional and trade groups, to create some uniformity, the various nuances of state property law often served as a significant roadblock.<sup>59</sup> Indeed, the lack of uniformity made the process of pooling and securitizing mortgage loans very difficult.<sup>60</sup>

Although not on the same scale as the Great Depression, an inflationary period in the late 1960s brought about a mortgage credit crisis as investors, due to low interest rates, sought higher yields in non-mortgage-related investments.<sup>61</sup> This resulted in a credit problem as banks suddenly lacked the funds necessary to continue making new home loans—regardless of the possibility of a government-backed guarantee through the FHA.<sup>62</sup> As a result, in 1970 Congress passed the Emergency Home Finance Act, which was aimed at making the secondary mortgage market more robust and expansive.<sup>63</sup> In the wake of this legislation, the GSEs stated that the first task they would undertake as a result of the new law was to create a “standard mortgage form.”<sup>64</sup> However, the process was not easy.<sup>65</sup> A large group of lawyers and housing advocates from various sectors came together to begin drafting the all-important document, but the voices often clashed as various interests often failed to align.<sup>66</sup> Lenders’ counsel wanted robust covenants and warranties imposed upon the borrower, while customer advocacy groups fought back for more protections for homeowners.<sup>67</sup> After much testimony, public hearings, and de-

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58. *See id.*; *see also* Peter M. Carrozzo, *Marketing the American Mortgage: The Emergency Home Finance Act of 1970, Standardization and the Secondary Market Revolution*, 39 REAL PROP. PROB. & TR. J. 765, 766 (2005) (“Until as late as the 1960s, mortgage lending occurred on a predominantly local scale; neighborhood banks and savings and loans lent homebuyers money that was financed by the savings of people in the community where the mortgage property was located. Lenders held these loans in their portfolios until maturity or the sale of the property.”).

59. *See* Forrester, *supra* note 57, at 1083; Raymond A. Jensen, *Mortgage Standardization: History of Interaction of Economics, Consumerism and Governmental Pressure*, 7 REAL PROP. PROB. & TR. J. 397, 398 (1972).

60. *See* Forrester, *supra* note 57, at 1083; Carrozzo, *supra* note 58, at 777 (quoting the testimony of Federal Reserve Board Governor Maisel that the creation of a secondary mortgage market would “hasten efforts to standardize the conventional residential mortgage—a desirable step in itself” due to the fact that at the time most mortgage contracts “[l]ack[ed] the degree of homogeneity required for active trading in the secondary market.” (alteration in original)).

61. Carrozzo, *supra* note 58, at 767–68.

62. *See id.*

63. Emergency Home Finance Act of 1970, Pub. L. No. 91-351, 84 Stat. 450; *see also* Carrozzo, *supra* note 58, at 767–68.

64. Forrester, *supra* note 57, at 1083 (“Fannie Mae and Freddie Mac agreed that their ‘first order of business must be the development of a standard mortgage form.’”).

65. *See id.*

66. *See id.* at 1084 (“These drafts contained many pro-lender provisions that were customarily contained in most mortgages. To the extent they limited the lender’s rights or remedies or gave the borrower rights, lenders objected. However, the more strenuous objections came from consumer groups.”).

67. *Id.* (“In response to demands for public hearings from Senator Proxmire and Ralph Nader, Fannie Mae and Freddie Mac held a public meeting about the forms on April 5-6, 1971. Although not technically a hearing, Congressman Albert Rains chaired the

bate, Fannie Mae and Freddie Mac developed a single form, arguably bent toward the borrower while still mindful of the creditor, and they jointly published the finished product.<sup>68</sup> As Professor Forrester notes, the form has been changed some over the years, but it remains largely the same as its 1970s iteration.<sup>69</sup>

### C. THE RESULT OF STANDARDIZATION

Once the uniform mortgage contract was completed, its use spread quickly.<sup>70</sup> In essence, Fannie Mae and Freddie Mac were the biggest players in the secondary mortgage market and, because of this, they set the rules of the game.<sup>71</sup> Both announced that they would only accept home loans that were secured by mortgages that appeared in their particular form.<sup>72</sup> Thus, all those originating banks and financial entities that wished to increase their immediate liquidity by selling their mortgage loans to Fannie Mae and Freddie Mac were forced to immediately switch over to using the uniform contract.<sup>73</sup> In fact, even financial institutions that originated home loans, but did not necessarily contemplate selling them on the secondary market, nevertheless issued the loans using the uniform mortgage.<sup>74</sup> The ubiquity of the uniform instrument throughout the housing finance market is a testament to the power that the GSEs and the secondary market play in mortgage lending nation-wide.

Importantly, most of the early work of the consumer groups who sat at the table and advocated on behalf of homeowners during those heated hearings and meetings in 1970 remains in place.<sup>75</sup> Indeed, the homeowners of today still enjoy the good work of these individuals each time they take out a home loan and sign the accompanying mortgage.<sup>76</sup> Some of the major pro-consumer provisions won from those battles are worthy of note. These include the availability of the fixed-term interest rate (a very important financial term for borrowers who might otherwise be worried about the volatility that can come along with an adjustable rate mortgage),<sup>77</sup> and the ability to repay the mortgage loan prior to the end of the term (and thereby avoid what can be significant future interest payments)

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meeting, and forty witnesses testified, including Nader. Consumer advocates criticized numerous provisions of the draft forms. Nader testified that Fannie Mae and Freddie Mac had ‘a golden opportunity to develop perhaps the first fair and balanced standardized form.’”).

68. *See id.*

69. *Id.* at 1085.

70. *See* Forrester, *supra* note 57, at 1085–87.

71. *See id.*

72. *See id.*

73. *Id.*

74. *See* Carrozzo, *supra* note 58, at 802–03.

75. Forrester, *supra* note 57, at 1084–85.

76. *See id.* at 1087 (“Because of their widespread use and their exceptionally fair terms, Fannie Mae/Freddie Mac uniform instruments provide a significant benefit to homeowners.”).

77. *See id.* at 1088 (“The primary benefit in financial terms offered by the GSEs is the availability of the long term fixed-rate loan.”).

without the need to pay a penalty or fee.<sup>78</sup> Further, borrowers benefit from mandatory default notice periods (30-days at a minimum) and limitations on late fees and penalties.<sup>79</sup>

Professor Forrester points out that just as significant as the terms included in the uniform mortgage contract are those that are absent from it.<sup>80</sup> Provisions that are frequently seen in “take-it-or-leave-it” contracts of adhesion are fairly absent from the residential mortgage.<sup>81</sup> These include waivers of a right to a trial by jury, arbitration clauses, and waivers of notice and other rights of the borrower.<sup>82</sup> Professor Forrester also notes that, although residential mortgage transactions are similar to other types of consumer transactions in that the consumer has no opportunity (or at least not a meaningful opportunity) to negotiate the terms of the deal, this unfavorable situation is mitigated by the fact that the creditor does not have the ability to unilaterally set the terms of the deal to skew in its favor because all lenders are forced to use a document that is pre-ordained and that has already been greatly influenced by consumer advocates.<sup>83</sup>

Standardization of the mortgage contract has played a tremendous role in the housing finance market in the United States. It has allowed for a system of reliable securitization of mortgage loans that, in turn, increase the liquidity of financial institutions and thereby augments their ability to provide more credit and increase homeownership. Similarly, it has been argued that standardization has resulted in mortgage contracts that are fairer to consumer debtors when compared with the “terms of commercial mortgage loan documents, subprime mortgage loan documents, and other types of consumer documents.”<sup>84</sup>

## II. HOUSING FINANCE, DODD-FRANK, AND REFORM REVISITED

Standardization and the secondary mortgage market revolutionized the way mortgage credit was created and made available in the U.S.<sup>85</sup> It has allowed individuals to become homeowners and has increased household wealth for many Americans.<sup>86</sup> Indeed, “the availability of affordable mortgage money and assembly-line lending practices . . . propel an unprecedented deluge of conveyances and refinances.”<sup>87</sup>

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78. *Id.* at 1089–90 (pointing out the benefits to homeowners in terms of refinancing their loans when interest rates dip).

79. *See id.* at 1090–91 (noting that there are some non-uniformities with this provision from state-to-state due to varying rights of the lender in each jurisdiction).

80. *See id.* at 1093–94.

81. *See* Forrester, *supra* note 57, at 1095 (citing Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1174, 1177 (1983)).

82. *See id.* at 1093–94.

83. *Id.* at 1095–96.

84. *See id.* at 1109.

85. Carrozzo, *supra* note 58, at 802–03.

86. *See* Grinstein-Weiss, *supra* note 12, at 4–5; *see also* Shlay, *supra* note 9, at 520.

87. *See* Carrozzo, *supra* note 58, at 802–03.

For the most part, mortgage lending and the wide availability of credit continued throughout the second half of the 20th century. However, financial free-wheeling and artificially rising home prices eventually caught up with mortgage credit markets, and when the housing market and larger economy crashed in 2007 and 2008, Congress was forced to respond.<sup>88</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 significantly overhauled many of the ways in which home loans are made<sup>89</sup> but, as discussed in the following section, it did very little to change the ways in which lenders dictate the relationship with their borrowers once credit is advanced through the lens of the mortgage contract.

#### A. MORTGAGE FINANCE IN THE U.S.

Indisputably, the acquisition of a home by most Americans comes from purchase-money borrowing from a lender, and the centerpiece of that relationship—between the borrower/homeowner and the lender—is the residential mortgage contract. As noted above, the provisions found in the standard residential mortgage contract were developed in the late 1960s during the hearings conducted in connection with the creation of the secondary mortgage market. These hearings had particular motivations, most of which dealt with liquidity and access to mortgage across the country

##### 1. *Housing Policies and Federally-Backed Mortgages*

To understand the significance of the terms in contemporary mortgage contracts and how they fit (or do not) into today's new regulatory landscape, it is necessary to understand the progression of mortgage credit all the way to the recent Great Recession.

While reams of paper have been dedicated to the causes of the 2008 crash, a summary of the major causes of the crisis are helpful.<sup>90</sup> Many housing experts have argued, quite persuasively, that federal housing and financial regulatory policy played at least some role in the crisis. Certainly the beginnings of homeownership and the expansion of mortgage credit can be found in the creation of the FHA, the GSEs, and then eventually

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88. BETHANY MCLEAN & JOE NOCERA, *ALL THE DEVILS ARE HERE, THE HIDDEN HISTORY OF THE FINANCIAL CRISIS* (Penguin Group 2010); Damian Paletta & Aaron Lucchetti, *Law Remakes U.S. Financial Landscape*, WALL ST. J. (July 16, 2010), <http://www.wsj.com/articles/SB10001424052748704682604575369030061839958> [<https://perma.cc/Y3NX-VZ4D>]; THE FINANCIAL CRISIS INQUIRY REPORT, NAT'L COMM'N ON THE CAUSES OF THE FIN. AND ECON. CRISIS IN THE UNITED STATES 7 (2011), <https://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf> [<https://perma.cc/GNN3-5B8X>] [hereinafter *Commission Report*].

89. Michael Simkovic, *Competition and Crisis in Mortgage Securitization*, 88 IND. L.J. 213, 264–68 (2013); Jann Swanson, *House Holds Another Hearing on Impact of Dodd-Frank Mortgage Requirements*, MORTG. DAILY NEWS (July 11, 2012), [http://www.mortgagebusinessdaily.com/07112012\\_dodd\\_frank\\_cfrb.asp](http://www.mortgagebusinessdaily.com/07112012_dodd_frank_cfrb.asp) [<https://perma.cc/JT7T-AZ3T>].

90. This Article does not in any way attempt to treat the issue comprehensively.

the secondary market for conventional mortgages, as noted above.<sup>91</sup> However, in the 1990s the federal government greatly loosened lending standards, and in 1995 the U.S. Department of Housing and Urban Development (HUD) set a national homeownership goal of 70%.<sup>92</sup> In order to meet this goal, as required by law, the GSEs relaxed their lending standards and started issuing loans with ever-increasing loan-to-value ratios.<sup>93</sup> When the GSEs reached the outer limits of their underwriting capabilities—unable to relax their standards any further—they began to purchase *subprime* securitized mortgage loans on the secondary market from private-label lenders (who did little to no meaningful underwriting) in order to further HUD's ambitious homeownership goals.<sup>94</sup> And indeed, by all accounts the GSEs have been integral in oiling the wheels of the housing market.<sup>95</sup> Through their own loan originations and through the mortgage purchases on the secondary market, Fannie and Freddie's total assets increased from \$78 billion in 1980 to \$3.6 trillion in 2003.<sup>96</sup> In fact, by 2010, these two entities "owned or guaranteed approximately half of all outstanding mortgages in the United States."<sup>97</sup> However, weak underwriting and federal policy-making trumped sound economic principles, eventually leading to wide, free-wheeling access to housing credit, and greatly contributing to the ultimate crash.<sup>98</sup>

## 2. Cheap Money, Securitization, and Conventional Mortgage Lending

It would be wrong to say that federal housing policy was the only contributor to the financial crash. If the government provided the car, greed, and predatory lending, risky financial engineering by private enterprise would serve as its driver. Nevertheless, one other government entity is worth mentioning in connection with the role that government policy played in the crisis. Prior to 2008, the Federal Reserve kept market interest rates incredibly low by way of its control over the federal funds rate.<sup>99</sup> This, in turn, provided greater access to mortgage credit, which many Americans viewed as a good way to obtain cheap money to invest in resi-

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91. See *supra* Part I.B-C.

92. See *Fannie Mae and Freddie Mac: How Government Housing Policy Failed Homeowners and Taxpayers and Led to the Housing Crisis: Hearing Before the Subcomm. on Capital Markets and Gov't Sponsored Enterprises of the H. Comm. on Financial Services*, 113th Cong. 9–10, 49–50 (2013) (statement of John Ligon, Policy Analyst in the Center for Data Analysis at the Heritage Foundation).

93. See *id.* at 50.

94. See *id.*

95. *Id.*

96. *Id.* at 49.

97. *Id.*

98. See *FHA*, *supra* note 56, at 51 (describing how homeownership goals drove underwriting).

99. See *Commission Report*, *supra* note 88, at 84 ("To stimulate borrowing and spending, the Federal Reserve's Open Market Committee lowered short-term interest rates aggressively.") They would lower the interest rate 11 times throughout 2001, down to a mere 1.75%. The interest rate had not been that low in over 40 years.

dential real estate.<sup>100</sup> And at least at the time, it was indeed a good investment.<sup>101</sup> During the early 2000s, home prices rose annually at a rate between 5.2% and 11.5%—staggering by anyone’s account.<sup>102</sup> Awash with cheap credit and confident in their home’s value, the average consumer jumped right in and borrowed even more.<sup>103</sup> National mortgage debt between 2001 and 2007 doubled, and the vast majority of this debt was through mortgage lending, much to the rejoicing of the banks.<sup>104</sup> Moreover, it was not merely new loans that brought about these mortgage transactions; the refinancing of existing mortgage debt was huge.<sup>105</sup> “In 2003 alone, lenders refinanced over \$15 million worth of mortgages, which amounted to more than one in four.”<sup>106</sup> Borrowers not only refinanced to take advantage of cheaper interest rates, but did so in an effort to cash out the ever-rising equity in their homes.<sup>107</sup> By one account, during this period homeowners in the U.S. cashed out \$430 billion in home equity loans.<sup>108</sup> A person’s home equity became a sort of piggy-bank, the funds from which could be used to pay for a number of expenses and luxuries.

Similarly, private lenders took advantage of the new influx of borrowers by making so-called “subprime” loans.<sup>109</sup> These loans were made to individuals who would never be able to qualify for otherwise carefully underwritten prime loans.<sup>110</sup> Subprime loans were expensive to borrowers—often comprising high fees and charges.<sup>111</sup> Most borrowers did not, however, understand how harmful these types of credit facilities could be at the time.<sup>112</sup> Moreover, these borrowers often lacked the knowledge or resources necessary to challenge the lender.<sup>113</sup> While there were various

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100. *See id.* at 83 (“Lower interest rates and broader access to credit were available for other types of borrowing, too, such as credit cards and auto loans.”).

101. *Id.* at 83–85.

102. *See id.* at 83, 85 (“In California, a house bought for \$200,000 in 1995 was worth \$454,428 nine years later.”).

103. *See id.* at 83.

104. *See id.* at 83–84.

105. *Commission Report*, *supra* note 88, at 83–84.

106. *See id.* at 86.

107. *See id.* at 86–87.

108. *See id.* at 87.

109. *Id.* at 88.

110. *See* Odinet, *supra* note 16, at 1159–60; *see also* Singer, *supra* note 16, at 507; Christopher L. Peterson, *Foreclosure, Subprime Mortgage Lending, and the Mortgage Electronic Registration System*, 78 U. CIN. L. REV. 1359, 1359 (2010); Gerald Korngold, *Legal and Policy Choices in the Aftermath of the Subprime and Mortgage Financing Crisis*, 60 S.C. L. REV. 727, 728–29 (2009); ADAM B. ASHCRAFT & TIL SCHUERMANN, FED. RES. BANK OF N.Y., STAFF REP. NO. 318, UNDERSTANDING THE SECURITIZATION OF SUBPRIME MORTGAGE CREDIT 5 (2008).

111. *See Commission Report*, *supra* note 88, at 90.

112. *See id.* (“A study by two Federal Reserve economists estimated at least 38% of borrowers with adjustable-rate mortgages did not understand how much their interest rates could reset at one time, and more than half underestimated how high their rates could reach over the years.”).

113. *See id.* (One professor of economics at Dartmouth College stated: “Comparing terms of financial contracts and shopping around before making financial decisions are not at all common among the population.”).



rules regarding mortgage lending throughout the 1980s, many of these were rolled back or eliminated in the 1990s under the auspices of providing more credit to traditionally underrepresented groups.<sup>114</sup> Moreover, financial regulators had little appetite to police the types of loans lenders made and to what type of borrowers credit was advanced.<sup>115</sup> For instance, when confronted with the possibility of creating rules to govern the underwriting of mortgage loans to new borrowers, the Office of the Comptroller of the Currency stated “[d]ecisions concerning the forms and terms of national bank lending are properly the responsibility of each bank’s directorate and management” and not a space to be occupied by the government.<sup>116</sup>

The final piece of the mortgage crisis was securitization.<sup>117</sup> Inextricably connected to the creation of the secondary mortgage market back in the 1970s,<sup>118</sup> this “process involved a labyrinthine scheme of buying, selling, swapping, and insuring . . . legal instruments that comprised a host of mortgage/credit rights through various nominees of the true parties.”<sup>119</sup> This system started with the financial institution—called the mortgage originator—that made the upfront loan to the borrower.<sup>120</sup> The originator would technically engage in an underwriting analysis of the borrower by looking at his credit history, employment status, and current obligations, among other things, and determine “whether the prospective homebuyer had the ability to repay the loan.”<sup>121</sup> “It was at this stage of the transaction that subprime borrowers—those who, by all the accounts, could not repay [their] loan—were nevertheless approved for credit.”<sup>122</sup> In turn, the borrower would sign a note and a mortgage contract—by now fairly uniform across the country—on the real property to secure it.<sup>123</sup>

Almost immediately after the advance, the originator would sell the

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114. See John Pottow, *Ability to Pay*, 8 BERKELEY BUS. L.J. 175, 178–79 (2011) (“Prior to 1982, there were good, old-fashioned rules (not standards) imposed by statute on mortgage originators, such as the hard cap of a ninety percent ‘loan-to-value’ (‘LTV’) ratio for improved real estate loans issued by national banks and maximum thirty-year full amortization terms for residential mortgages. Then the headiness of 1980s deregulation brought such developments as the Garn-St. Germain Act (and the related Alternative Mortgage Transactions Parity Act), which boldly dispatched such backward-thinking, heavy-government suffocation of consumer credit. Recall that the Community Reinvestment Act (‘CRA’) was passed in 1977, and so such deregulatory moves were not only consonant with the spirit of the 1980s but could also be couched in the credit-opening rhetoric of bringing homeownership to historically underserved communities under the civil-rights era policies of the CRA. With traditional mortgage lenders liberated from their ‘stodgy’ underwriting standards, housing would come to everyone at last!”).

115. See *id.*

116. See *id.* at 179 (citing Real Estate Lending by National Banks, 48 Fed. Reg. 40,699 (Sept. 9, 1983) (codified at 12 C.F.R. pts. 7, 34)).

117. See Odinet, *supra* note 16, at 116–65.

118. See Carrozzo, *supra* note 58, at 800–01.

119. See Odinet, *supra* note 16, at 1163.

120. *Id.* at 1163–64.

121. *Id.* at 1164.

122. *Id.*

123. *Id.*

loan package to a third-party called an arranger.<sup>124</sup> These arrangers would purchase a host of mortgage loans from various originators and, through an aggregation process, create a form of security that could then be bought, sold, or traded to third party investors, typically through the investor purchasing a nominal interest in a special purpose vehicle (like a trust) that would have ownership of the pooled mortgage loans.<sup>125</sup> These were called mortgage-backed securities. As noted above, the biggest purchasers of these mortgage-backed securities were the GSEs—Fannie Mae and Freddie Mac.<sup>126</sup> Indeed, as noted above, they were created for the sole purpose of facilitating a secondary mortgage market.<sup>127</sup> Shortly after the Emergency Home Finance Act of 1970 was passed, securitization took hold.<sup>128</sup> The first occurred at the end of September 1977 when “the first private offering of interests in a pool of conventional mortgages” was made.<sup>129</sup> The investment pool consisted of mortgage loans made between 1972 and 1977, representing about 2,818 promissory notes with an interest rate of 8.75% with 30-year payment terms and a loan-to-value ratio of 80%.<sup>130</sup> “The mortgage industry embraced the movement; securitization of home mortgage loans exploded in the 1980s.”<sup>131</sup> Meanwhile, at the core of this system remained the standardized residential mortgage—the link between the borrower, the lender, and the system that oiled the wheels of mortgage credit nation-wide.<sup>132</sup>

It is important to bear in mind that the only thing that changes from the borrower’s point of view as a result of securitization is that she is now required to make her mortgage payments to a nominee of the investors—the mortgage servicer—rather than to the original lender.<sup>133</sup> The servicer is in charge of not only collecting the required monthly payments but also dealing directly with the borrower in the event any issues arose.<sup>134</sup>

“[T]he ability of mortgage lenders to off-load their risk to third parties almost immediately upon making the risky loan removed a major protection for borrowers.”<sup>135</sup> The lender had no “skin in the game,” and therefore was not made to bear the risks associated with making the loan, since by the time a default might occur the economic loss would fall upon another party.<sup>136</sup>

Importantly, those who invested in these mortgage pools were significant players in the American economy—which made the eventual crash

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124. *Id.*

125. Odinet, *supra* note 16, at 1164.

126. *See FHA*, *supra* note 56, at 17–18.

127. *See id.* at 3, 17–18.

128. *See Carrozo*, *supra* note 58, at 800–01.

129. *See id.* at 800.

130. *Id.* at 800–01.

131. *Id.* at 801.

132. *See id.* at 797–99.

133. *See Odinet*, *supra* note 16, at 1164.

134. *Id.* at 1164–65.

135. *Id.* at 1164.

136. *See id.* at 1162, 1165.

all the more disastrous.<sup>137</sup> Many large institutional investors such as pension systems, hedge funds, and large portfolio investors had moved away from treasury bonds and similar instruments due to the low yield rate on those investments (driven in large part by the Federal Reserve's suppression of interest rates discussed above).<sup>138</sup> Instead, they shifted over to purchasing alternative assets, like securitized mortgage loans.<sup>139</sup> These collateral-backed mortgage securities proved to be a favorite and they spread like wildfire.<sup>140</sup> Through this process, mortgage-backed securities—consisting of subprime loans obtained by borrowers through little to no underwriting and secured by soon to be worthless collateral—as well as their derivatives (like collateralized debt obligations (CDOs) and synthetic CDOs) came to infect almost all sectors of the American financial economy.<sup>141</sup> And yet, at the core of the crisis stood the standard residential mortgage contract—unchanged, still allegedly consumer-oriented, and little noticed.

#### B. DODD-FRANK AND MORTGAGE REFORM

The magnitude of the damage caused by the economic crisis of 2008, which was driven largely by failed housing policies and risky financial engineering, spurred Congress and the President to action.<sup>142</sup> This government response was tremendous in both its breadth and depth.<sup>143</sup> Part of Congress's actions involved the injection of trillions of dollars in emergency loans and in the purchasing of equity stakes in failing financial institutions.<sup>144</sup> This period of muscular government intervention in private financial markets was supported in large part by the so-called "too big to fail" policy.<sup>145</sup> This concept stood for the notion that certain financial institutions, because of their wide reach and integration into the American economy, would cause so much damage if they were allowed to fail that expenditures of taxpayer money were justified in keeping them afloat and attempting to bring them back to financial health.<sup>146</sup>

However, the largest effort, and the one that is of concern in this article, was Congress's attempt to overhaul the financial regulatory system in the U.S.<sup>147</sup> The centerpiece of this effort was the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), passed in

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137. *See id.* at 1166.

138. *See* Ligon, *supra* note 92, at 50–52.

139. *See id.*

140. *See* Singer, *supra* note 16, at 501.

141. *Id.* at 511.

142. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-13-180, FINANCIAL REGULATORY REFORM: FINANCIAL CRISIS LOSSES AND POTENTIAL IMPACTS OF THE DODD-FRANK ACT 1 (2013) [hereinafter *GAO: Financial Reform*].

143. *See id.*

144. *See id.*

145. *See id.* at 39.

146. *See id.* at 11, 38.

147. *See id.* at 1.

2010.<sup>148</sup> The over-riding goal of the legislation was to deal with future risks to the stability of the American economy, to prevent any future “too big to fail” bailouts of large financial institutions, and to create new and strengthen existing protections for consumers and investors, in part, by creating more transparency and regulation for the more complex and risky financial products that had caused or contributed to the crisis.<sup>149</sup>

### 1. Background and Overview of the CFPB

A key offspring of the Dodd-Frank Act is the newly created Consumer Financial Protection Bureau (CFPB).<sup>150</sup> The CFPB represents a concept, most prominently proposed by then law professor, now U.S. Senator, Elizabeth Warren, in 2007 and championed by a host of consumer finance-focused legal academics.<sup>151</sup> Essentially, the bureau is an independent agency within the Federal Reserve that focuses on the regulation and enforcement of consumer protection in the financial sector.<sup>152</sup> While these general duties were previously spread across a variety of disparate agencies ranging from the Federal Reserve, HUD, the Treasury, the FDIC and beyond, the Dodd-Frank Act consolidated these functions and responsibilities, in most cases, into one agency— the CFPB.<sup>153</sup>

The CFPB has oversight of many areas of the U.S. financial economy, ranging from securities, credit cards, bank and non-bank monitoring, payday lenders, and student loans.<sup>154</sup> While various other agencies, such as the Federal Reserve, the Securities and Exchange Commission, and state-level banking supervisors still play a partial or even primary role in the

148. Dodd-Frank Wall St. Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (codified as amended in scattered sections of 7, 12, 15, and 31 U.S.C.); see also Damian Paletta, *U.S. Lawmakers Reach Accord on New Finance Rules*, WALL ST. J. (Jun. 25, 2010), <http://www.wsj.com/articles/SB10001424052748703615104575328020013164184> [https://perma.cc/NLC4-H3CF]; Reza Dibadj, *Dodd-Frank: Toward First Principles?*, 15 CHAP. L. REV. 79, 79 (2011); Gary L. Goldberg, *Dodd-Frank Act at One Year: An Overview*, 65 CONSUMER FIN. L.Q. REP. 229, 229 (2011).

149. See GAO: *Financial Reform*, supra note 142, at 5.

150. Alan S. Kaplinsky, *CFPB Announces 2013 Regulatory Agenda*, 66 CONSUMER FIN. L.Q. REP. 418, 404 (2012); Steve Forry, *The CFPB in Review: A Healthy Dose of Enforcement and a Dash of Setting Boundaries*, 32 NO. 10 BANKING & FIN. SERVICES POL’Y REP. 1, 1 (2013), at 1; Jean Eaglesham, *Warning Shot On Financial Protection*, WALL ST. J. (Feb. 9, 2011), <http://www.wsj.com/articles/SB10001424052748703507804576130370862263258> [https://perma.cc/MBU2-7HYV].

151. Elizabeth Warren, *Unsafe at Any Rate*, DEMOCRACY (2007), <http://democracyjournal.org/magazine/5/unsafe-at-any-rate/> [https://perma.cc/4ZMJ-72ZJ]. While certainly the most prominent, many other academics pushed for the creation of such an umbrella agency for consumer protection as well. See Vern Countryman, *Improvident Credit Extension: A New Legal Concept Aborning?*, 27 ME. L. REV. 1 (1975); see also John A. E. Pottow, *Private Liability for Reckless Consumer Lending*, 2007 U. ILL. L. REV. 405, 407 (2007); Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1258 (2002).

152. VIRAL V. ACHARYA & THOMAS F. COOLEY, *REGULATING WALL ST.: THE DODD-FRANK ACT AND THE NEW ARCHITECTURE OF GLOBAL FINANCE* 6 (Viral V. Acharya et al. eds., 2010).

153. DAVID H. CARPENTER, CONG. RESEARCH SERV., R42572, *THE CONSUMER FINANCIAL PROTECTION BUREAU (CFPB): A LEGAL ANALYSIS* 1 (2014).

154. See *id.* at 13, 17.

regulation of several of these areas, the CFPB shares a great deal of the power and responsibility when it comes to ensuring a safe and sound U.S. financial sector.<sup>155</sup> For purposes of this article, the CFPB's authority over the mortgage finance sector of the economy is particularly significant.<sup>156</sup> Unsurprisingly, because of the many fault lines discussed above regarding housing policy and the financial engineering of the recent past, the first major project of the CFPB was to create rules to end subprime borrowing and the complete lack of underwriting that had been so pervasive in the pre-2008 housing finance sector.<sup>157</sup> These changes are significant because despite the massive ways in which they have altered the mortgage finance system in the United States, they did little-to-nothing to change the content of the central document that governs the relationship between the homeowners and his lender—the mortgage contract.<sup>158</sup>

## 2. *Assessing the Ability to Repay*

The first major way that the CFPB changed the housing finance system was to impose what had, until now, been merely good practice—meaningful underwriting.<sup>159</sup> While lenders had at various times been more or less muscular in their use of underwriting criteria in issuing mortgage loans, the CFPB altered the landscape significantly by requiring that underwriting take place for all new mortgage loans.<sup>160</sup> Moreover, stiff penalties and dire consequences could be brought down upon a lender who failed to engage in this process.<sup>161</sup>

Specifically, Section 1411(b) of the Dodd-Frank Act changed the Truth In Lending Act (TILA) by creating a section 1411 entitled the “Mortgage Reform and Anti-predatory Lending Act.”<sup>162</sup> This section states that:

[N]o creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance), and assessments.<sup>163</sup>

The legislation further specifies that this determination can be made using a number of different factors.<sup>164</sup> For instance, a lender may look to the borrower's credit history and current levels of income.<sup>165</sup> The lender also has the flexibility to take into consideration any future income that

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155. *See id.* at 9, 20.

156. Todd Zywicki, *The Consumer Financial Protection Bureau: Savior or Menace?*, 81 GEO. WASH. L. REV. 856, 882 (2013).

157. *See id.* at 908.

158. *See id.*

159. 15 U.S.C. § 1639c(a)(1) (2010).

160. *Id.*

161. *Id.* § 1640.

162. *Id.* § 1639c(a)(1).

163. *Id.*; *see also* H.R. REP. NO. 111–94, at 8 (2009).

164. 15 U.S.C. § 1639c(a)(3) (2010).

165. *Id.*

the borrower might reasonably expect to receive in the future.<sup>166</sup> The lender must also analyze the current liabilities and debts of the borrower that would otherwise compete with the mortgage's debt servicing requirements.<sup>167</sup> Employment status, debt-to-income ratios, and access to income after the borrower satisfies all mortgage and non-mortgage related obligations are also included in the analysis.<sup>168</sup> Moreover, lenders cannot make these determinations based solely from the information provided by the borrower.<sup>169</sup> In most instances, the lender must verify the documentation based on information provided by reliable third parties.<sup>170</sup> And importantly, the Dodd-Frank Act requires that residential mortgage loans provide for a term that is fully amortizing.<sup>171</sup>

The CFPB followed up by issuing rules that elaborated on the new ability to repay requirements found in Dodd-Frank, made effective January 1, 2014, by adding Section 1026.43 to Regulation Z.<sup>172</sup> Among other things, the regulations provide that monthly payments must be calculated by assuming that the loan will be repaid in equal, monthly installments during its term.<sup>173</sup> It also defines total debt obligations, a phrase used to determine debt-to-loan ratios, as "the sum of payments on the loan, simultaneous loans, mortgage-related obligations, current debt obligations, alimony, and child support."<sup>174</sup> The regulation also provides that lenders must maintain loan records evidencing compliance with the ability to repay requirement for three years after each loan is made.<sup>175</sup>

Failure to comply with the guidelines for these new underwriting requirements can be severe.<sup>176</sup> First, a lender who violates the duty to make a good faith determination as to a borrower's ability to repay is subject to the standard damages remedy that already exists under the Truth in Lending Act, which includes "actual damages, statutory damages (which are in the nature of punitive damages), and if the consumer prevails, attorneys' fees and court costs."<sup>177</sup> More importantly however, violation of this underwriting duty can serve as a defense by the borrower in seeking

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166. *Id.*

167. *Id.*

168. *Id.*

169. *Id.*

170. 15 U.S.C. § 1639c(a)(4).

171. *Id.*

172. Michael B. Mierzewski et al., *CFPB Finalizes Ability-to-Repay and Qualified Mortgage Rule*, 130 BANKING L.J. 611, 611 (2013) (codified as 12 C.F.R. § 1026.43 (2013)). Regulation Z is the omnibus federal regulation that interprets the provision of the Truth in Lending Act (TILA). See Press Release, *CFPB Lays Out Implementation Plan for New Mortgage Rules*, CONSUMER FIN. PROTECTION BUREAU (Feb. 13, 2013), <http://www.consumerfinance.gov/newsroom/consumer-financial-protection-bureau-lays-out-implementation-plan-for-new-mortgage-rules/> [<https://perma.cc/CCW2-22WS>].

173. Robert K. Olsen & Jessica Nguyen, *An Overview of the New Ability-to-Repay and Qualified Mortgage Rules Under the Dodd-Frank Act*, 33 NO. 10 BANKING & FIN. SERVICES POL'Y REP. 14, 15–16 (2014); see also Mierzewski et al., *supra* note 172, at 613.

174. Mierzewski et al., *supra* note 172, at 614.

175. *Id.*

176. 15 U.S.C. § 1640(a) (2010).

177. See Olsen, *supra* note 173, at 19.

to arrest a foreclosure (whether judicial or non-judicial).<sup>178</sup> For a lender facing a mountain of defaulted properties that desperately need to be processed through foreclosure, a legal defense based on a lack of underwriting can cause a significant problem. Lastly, if statutory damages are awarded, these can include amounts equal to the aggregate of all finance charges and other fees paid by the borrower.<sup>179</sup>

### 3. *The Qualified Mortgage*

For those mortgage lenders concerned with the uncertainty of whether their particular underwriting method meets the ability to repay requirement—a fact that can practically only be discovered once the loan is made and it is too late—the CFPB provides some relief.<sup>180</sup> This relief comes in the form of a safe harbor that, if met by a mortgage lender, creates a presumption (in some cases conclusively and in others rebuttable) that the loan meets Dodd-Frank’s underwriting requirements.<sup>181</sup> This safe harbor takes the form of a mortgage loan package that contains certain terms and complies with heightened underwriting requirements.<sup>182</sup> It is known as the “qualified mortgage.”<sup>183</sup>

The concept is not entirely unique to Dodd-Frank. Indeed, in 2009, the Federal Reserve issued a rule imposing a duty to assess a borrower’s ability to repay certain high-priced mortgage loans, and an accompanying qualified mortgage safe harbor for those as well.<sup>184</sup> But Dodd-Frank, through the CFPB, took these concepts and ran with them by making

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178. *Id.*

179. *Id.*

180. Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 6408–01, 6504 (Jan. 30, 2013).

181. 15 U.S.C. § 1639c(b)(1) (2015) (“Any creditor with respect to any residential mortgage loan, and any assignee of such loan subject to liability under this subchapter, may presume that the loan has met the requirements of [the ability to repay], if the loan is a qualified mortgage.”); *see also* Olsen & Nguyen, *supra* note 173, at 17.

182. Stephen F. J. Ornstein et al., *CFPB Ability-to-Repay Rule and Qualified Mortgage Definition*, 66 CONSUMER FIN. L.Q. REP. 417, 349 (2012).

183. *See id.* at 391–92 (“Approximately two years ago, the Board of Governors of the Federal Reserve System (FRB) proposed a rule amending Regulation Z to implement an expanded ability-to-repay mortgage loan requirement and define a ‘qualified mortgage’ in accordance with various Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) amendments to the Truth in Lending Act (TILA). Responsibility for this rulemaking with respect to Regulation Z passed to the Consumer Financial Protection Bureau (CFPB) on July 21, 2011. On January 10, 2013, the CFPB completed the initial phase of this rulemaking process by issuing an ability-to-repay final rule that will fundamentally reshape the residential mortgage loan market (the 2013 ATR Final Rule). Effective January 10, 2014, the 2013 ATR Final Rule: (1) institutes a broad ability-to-repay requirement applicable to virtually the entire residential mortgage market; (2) defines a new category of ‘qualified mortgage’; and (3) establishes a two-tier safe harbor/rebuttable presumption legal structure for assessing compliance with the ability-to-repay requirement for ‘qualified mortgages’ that roughly distinguishes between ‘prime’ and ‘subprime’ mortgage loans.”).

184. *Summary of the Ability-to-Repay and Qualified Mortgage Rule and the Concurrent Proposal*, CONSUMER FIN. PROTECTION BUREAU, [http://files.consumerfinance.gov/f/201301\\_cfpb\\_ability-to-repay-summary.pdf](http://files.consumerfinance.gov/f/201301_cfpb_ability-to-repay-summary.pdf) [<https://perma.cc/QL8W-D5GC>].

them applicable to all mortgage loans, whatever their terms.<sup>185</sup>

The qualified mortgage loan is any residential mortgage loan that meets certain low-risk underwriting requirements.<sup>186</sup> First, the payments made by the borrower cannot result in an increase in the principal, and the loan agreement cannot allow a borrower to defer the payment of the principal (thereby cutting off the possibility of negative amortizing loans and loans with varying payment choices).<sup>187</sup> Second, all financial information relative to the borrower's income and economic resources must be well documented and substantiated.<sup>188</sup> Third, loans that call for balloon payments are absolutely prohibited.<sup>189</sup> Fourth, loans with fixed interest rates must be underwritten using a fully amortized payment schedule, and loans with adjustable interest rates must be underwritten using the maximum rate allowed under the loan for the first five years of the term, with a payment schedule that fully amortizes it over the entire term of the loan.<sup>190</sup> Both of these requirements are meant to ensure the borrower is not hit with a "payment shock" during the duration of the loan.<sup>191</sup> Sixth, the loan must adhere to certain debt to income ratios.<sup>192</sup> Seventh, so-called points and lender fees can be no more than three percent of the entire loan amount,<sup>193</sup> and eighth, the term of the loan cannot be greater than thirty years, with some exceptions.<sup>194</sup>

If a mortgage loan meets these requirements, it passes the ability to repay test and, although provided in more specificity in companion regulations, can even provide an avenue for lenders to avoid the credit retention provisions of the Dodd-Frank Act.<sup>195</sup> The aim of the CFPB was to create, as mortgage law scholar Professor David Reiss notes, "a kind of 'plain vanilla' mortgage option that lenders will want to originate because it poses fewer regulatory and litigation risks."<sup>196</sup>

It is important to note that these various regulatory requirements imposed on mortgage lenders represent an extreme departure from the

185. *See id.*

186. *See* David Reiss, *Message in a Mortgage: What Dodd-Frank's "Qualified Mortgage" Tells Us About Ourselves*, 31 REV. BANKING & FIN. L. 717, 722 n.13 (2012).

187. 15 U.S.C. § 1639c(b)(2)(A)(i) (2015).

188. *See id.* § 1639c(b)(2)(A)(iii).

189. *Id.* § 1639c(b)(2)(A)(ii).

190. *Id.* § 1639c(b)(2)(A)(iv)–(v).

191. *See* Reiss, *Message in a Mortgage*, *supra* note 186, at 724.

192. 15 U.S.C. § 1639c(b)(2)(A)(vi).

193. *Id.* § 1639c(b)(2)(A)(vii).

194. *Id.* § 1639c(b)(2)(A)(viii) (stating that there are exceptions for certain loans in high-cost areas).

195. *See* Reiss, *supra* note 186, 722–23 ("The 'Qualified Mortgage' is one that is privileged by Dodd-Frank in order to incentivize lenders to originate them instead of other types of mortgages. The 'Qualified Mortgage' provides lenders with a safe harbor from certain provisions of the Truth In Lending Act ('TILA') as well as from Dodd-Frank's mandatory 'ability to repay' underwriting standards. Dodd-Frank leaves the term 'Qualified Residential Mortgage' to be defined by federal regulators, but it must be no broader than a 'Qualified Mortgage.' The 'Qualified Residential Mortgage' is exempted from the credit risk retention ('skin in the game') provisions that apply to securitizers and originators of asset-backed securities.").

196. *See id.* at 723.



methods of the past.<sup>197</sup> As noted commercial law professor John Pottow observed, classic contract law in the realm of lenders declares that “absent special circumstances, a loan does not establish a fiduciary relationship between a commercial bank and its debtor.”<sup>198</sup> Moreover, courts have consistently declined to impose upon lenders a common law duty to determine whether their borrowers possessed the ability to repay when advancing credit.<sup>199</sup> As one court noted: “[t]he lender has no judicially imposed duty to ensure [the] ability to repay the loan . . .”<sup>200</sup> And the lack of a duty extends further than that; Professor Pottow notes that traditionally, “lenders do not even owe borrowers a duty of care to avoid negligence in the lending process.”<sup>201</sup> Dodd-Frank and the CFPB’s regulations represent a sea change in the mortgage lending paradigm.

### C. THE MARKET RESPONDS: EXPLORING THE DATA

The ability to repay and the qualified mortgage have been both criticized and praised.<sup>202</sup> Opponents argue that they represent the worst kind of paternalism by limiting the freedom and flexibility enjoyed by lenders in offering a variety of credit products to financial consumers, and by restricting the options borrowers have when it comes to home buying.<sup>203</sup> Moreover, a primary complaint in the wake of these regulations was that they would result in the tightening of credit and a significant decline in the possibility of homeownership for many Americans.<sup>204</sup>

197. See Pottow, *supra* note 114, at 178–79.

198. *Id.* at 177 (citing *Das v. Bank of America*, 186 Cal. App. 4th 727, 740 (2010)).

199. *Id.*

200. *Id.* at 178.

201. *Id.*

202. *Let’s Pretend Dodd-Frank Works*, WALL ST. J. (Dec. 12, 2014 12:17 PM), <http://www.wsj.com/articles/lets-pretend-dodd-frank-works-1418343970> [<https://perma.cc/DTU7-BQAD>]; see also Victoria McGrane, *Wall Street, Banks Press to Shape Dodd-Frank Rules*, WALL ST. J. (April 22, 2011 12:01 AM), <http://www.wsj.com/articles/SB10001424052748704889404576277364034089104> [<https://perma.cc/D5Q2-FU6F>]; Gretchen Morgenson, *Kicking Dodd-Frank in the Teeth*, N.Y. TIMES (Jan. 10, 2015), [http://www.nytimes.com/2015/01/11/business/kicking-dodd-frank-in-the-teeth.html?\\_r=0](http://www.nytimes.com/2015/01/11/business/kicking-dodd-frank-in-the-teeth.html?_r=0) [<https://perma.cc/P2YJ-JRH6>] (“The 114th Congress has been at work for less than a week, but a goal for many of its members is already evident: a further rollback of regulations put in place to keep markets and Main Street safe from reckless Wall Street practices.”); Jonathan Weisman & Eric Lipton, *In New Congress, Wall St. Pushes to Undermine Dodd-Frank Reform*, N.Y. TIMES (Jan. 13, 2015), <http://www.nytimes.com/2015/01/14/business/economy/in-new-congress-wall-st-pushes-to-undermine-dodd-frank-reform.html> [<https://perma.cc/27G5-MNBX>]; Mark A. Calabria, *Mortgage Reform under the Dodd-Frank Act 1* (Cato Inst., Working Paper No. 15, 2014), <http://object.cato.org/sites/cato.org/files/pubs/pdf/working-paper-15.pdf> [<https://perma.cc/A5WH-EJEX>] [hereinafter *Mortgage Reform*].

203. See Reiss, *supra* note 186, at 725; Clifford Rossi, *Final Qualified Mortgage Rule Should Get Us Back to Basics*, AMERICAN BANKER (April 11, 2012), <http://www.americanbanker.com/bankthink/final-qualified-mortgage-rule-should-get-us-back-to-basics-1048282-1.html> [<https://perma.cc/9PS9>] (“Creating a final rule that is restrictive in terms of what constitutes a qualified mortgage has the potential of limiting the scope of available mortgage products, and thus potentially constraining access to mortgage credit and potentially raising borrowing costs.”).

204. See Mark A. Calabria, *On “Regulatory Burdens to Obtaining Mortgage Credit”* (Cato Inst., Working Testimony to the Comm. on Banking, Housing and Urban Affairs,

As a number of scholars and consumer advocates have noted, it is still too early in the process to judge whether credit has been meaningfully restricted by the CFPB's new mortgage lending regulations.<sup>205</sup> However, there is at least enough data to show one important thing: lenders are overwhelmingly choosing to make loans that meet the qualified mortgage standard. As industry watchers and legal scholars always declare, financial markets and lending institutions are allergic to risk.<sup>206</sup> The possibility of the imposition of heavy fines and uncertain litigation—not to mention the inability to off-load newly originated loans on the secondary mortgage market and thereby increase access to capital—provides powerful incentives for mortgage lenders to run toward the qualified mortgage.<sup>207</sup> According to the National Association of Realtor's survey of mortgage originators, in the fourth quarter of 2015 the national percentage of mortgage loans made to borrowers that met the qualified mortgage safe harbor was 88.1%, with that number being fairly static compared to the second and third quarters of 2015.<sup>208</sup>

Most interestingly, the share of non-qualified mortgage loans—those that must merely meet the more discretionary “ability to repay” standard—was a mere 1.5% in the fourth quarter of 2015.<sup>209</sup>

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United States S., April 16, 2015), <http://www.cato.org/publications/testimony/regulatory-burdens-obtaining-mortgage-credit> [<https://perma.cc/NL99-JZ9Y>].

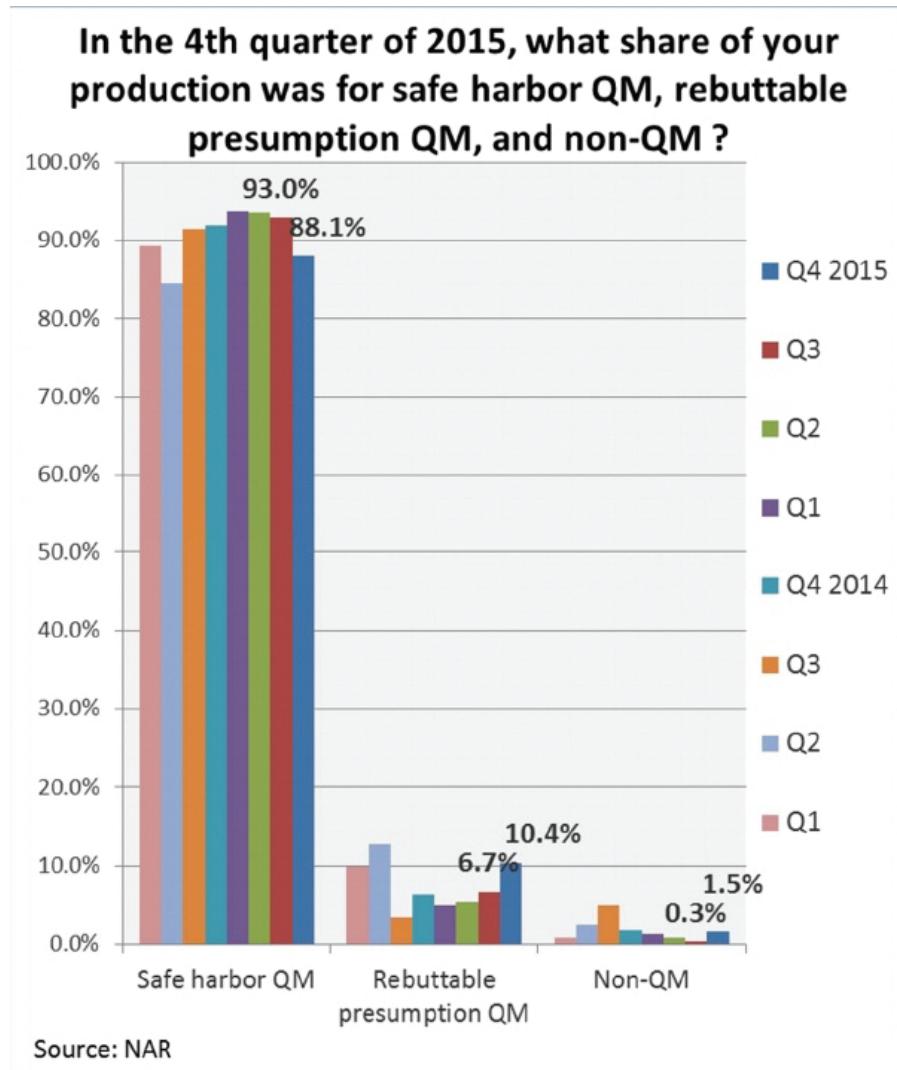
205. Lisa Prevost, *‘Qualified’ Loans, Redefined*, N.Y. TIMES (Nov. 7, 2013), <http://www.nytimes.com/2013/11/10/realestate/qualified-loans-redefined.html> [<https://perma.cc/9DHX-ATVF>] (quoting chief economist at Zillow.com Stan Humphries: “The question is, how much lending activity are we going to see emerge around the Q.M. box?”); see Calabria, *Mortgage Reform supra* note 202, at 11 (“A goal of the Dodd-Frank Act is to eliminate certain products and practices from the mortgage market. So at a very basic level the choices facing mortgage borrowers will be reduced, the difficult question is in gauging how much.”).

206. See Joshua Rauh, *The Looming Pension Crisis?*, YOUTUBE (Jan. 25, 2013), <https://www.youtube.com/watch?v=6SS4F1Zr1ZI> [<https://perma.cc/G36L-8N48>] (noting the ways in which even global financial markets react to even the most minor of economic uncertainties.)

207. Floyd Norris, *Mortgages Without Risk, at Least for the Banks*, N.Y. TIMES (Nov. 28, 2013), <http://www.nytimes.com/2013/11/29/business/mortgages-without-risk-at-least-for-the-banks.html> [<https://perma.cc/GZ8H-9M2P>] (“There was no single cause of the financial crisis, but a chief one was surely the way mortgage loans were made by people who believed they had no reason to care if the loan was repaid. That was why the Dodd-Frank financial overhaul law included risk retention—called ‘skin in the game’—as a major reform.”); see Elizabeth C. Yen, *Borrower Suitability Standards for Residential Mortgage Loans—The Need to Educate Home Buyers and Home Owners About Hidden Risks Associated with “Plain Vanilla” Qualified Residential Mortgage Loans*, 31 NO. 12 BANKING & FIN. SERVICES POL’Y REP. 1, 3 (2012).

208. NAT’L ASS’N OF REALTORS, SEVENTH SURVEY OF MORTGAGE ORIGINATORS 2015 2 (Aug. 17, 2015), <http://www.realtor.org/reports/august-2015-mortgage-originators-survey> [<https://perma.cc/4L3A-7NW6>].

209. *Id.*



This data indicates that the overwhelming share of new home mortgage borrowers are meeting very rigorous underwriting standards. Their ability to repay is arguably stronger and more reliable than any borrower in the recent past—and certainly much more than during the pre-2008 period. Moreover, these homeowners, like those in the past, can still rely upon a host of legal protections (ranging from taxation, criminal law, property law, and tort) that create a favorable environment for homeownership. But one area remains unchanged and is still unduly harsh for homeowners—the mortgage contract itself.

### III. THE UNFINISHED BUSINESS OF DODD-FRANK: REFORMING THE MORTGAGE CONTRACT

Dodd-Frank has certainly heralded a new era in financial regulation.<sup>210</sup> Indeed, the creation of the CFPB alone has changed the mood of many in the financial sector.<sup>211</sup> Nevertheless, even the Act's most ardent supporters have complained that the law does not go far enough. For instance, many contend that the legislation's insufficiency deals with banks that may become "too big to fail."<sup>212</sup> Similarly, the Act does not address the "moral hazard" aspects of banking and contains a host of loopholes that help banks and financial institutes escape some of the more stringent aspects of the law.<sup>213</sup> The president of the federal reserve bank in Dallas has been a particular critic of Dodd-Frank's shortcomings in the way it deals with systemically important financial institutions: "The credibility of Dodd-Frank's disavowal of [too-big-to-fail] will remain in question until a big financial institution actually fails and the wreckage is quickly removed so the economy doesn't slow to a halt."<sup>214</sup> Also, noted economists, Paul Krugman and Robert Schiller, argue that the capital requirements for depository institutions are still not high enough and the Act does not deal in a meaningful way to diminish the systemic risk that is inherent in the banking system.<sup>215</sup> These criticisms are probably best summed up by Professor Steven Schwarcz, who argues that Dodd-Frank took a microprudential approach to regulating the financial sector, when the root causes of the crisis were much more macro in scope, and thus should have been addressed in a similar fashion.<sup>216</sup>

210. Susan B. Zaunbrecher, *Dodd-Frank Bill Reshapes Businesses*, NAT'L L. REV. (July 17, 2010), <http://www.natlawreview.com/article/dodd-frank-bill-reshapes-businesses> [https://perma.cc/NF2F-XVTP].

211. Kerri Ann Panchuk, *Mortgage Insurers Respond to CFPB Enforcement Action*, HOUSING WIRE (April 4, 2013), <http://www.housingwire.com/articles/mortgage-insurers-respond-cfpb-enforcement-action> [https://perma.cc/48YC-8LUP].

212. Steven J. Markovich, *The Dodd-Frank Act*, COUN. ON FOREIGN REL. BACKGROUNDEERS (Dec. 10, 2013), <http://www.cfr.org/united-states/dodd-frank-act/p28735> [https://perma.cc/X6SK] [hereinafter *CFR Backgrounders*].

213. *See id.* ("But there is still much debate over the Volcker rule, and some analysts expect banks to wage a legal battle in the months ahead. Some critics argue it is not strong enough and contains potential loopholes. For instance, many speculate whether banks might be able to disguise taking their own speculative positions as market-making for clients or as the hedging of risk, which are still permitted under the regulation. The Volcker rule includes measures and formulas that will attempt to discern whether trades are proprietary, but it's unclear whether these will be sufficient.").

214. Yves Smith, *Dallas Fed's Fisher Criticizes Dodd Frank as Not Going Far Enough on TBTF*, NAKEDCAPITALISM.COM (March 21, 2012), <http://www.nakedcapitalism.com/2012/03/dallas-feds-fisher-criticizes-dodd-frank-as-not-going-far-enough-on-tbtf.html> [https://perma.cc/2FK3-EERV].

215. Xaxnar, *Krugman on Dodd-Frank*, DAILY KOS (Aug. 3, 2014), <http://www.dailykos.com/story/2014/8/3/1318917/-Krugman-on-Dodd-Frank> [https://perma.cc/A226]; *see also* William Alden, *Shiller: Dodd-Frank Does Not Solve Too Big To Fail*, HUFFINGTON POST (May 25, 2011), [http://www.huffingtonpost.com/2010/10/26/robert-shiller-dodd-frank-too-big-to-fail\\_n\\_774302.html](http://www.huffingtonpost.com/2010/10/26/robert-shiller-dodd-frank-too-big-to-fail_n_774302.html) [https://perma.cc/HN4F-2NF5].

216. Steven L. Schwarcz, *Macroprudential Regulation of Mortgage Lending*, 69 SMU L. REV. 595 (2016).

While all of these may be true and reasonable critiques of the law, there is one significant matter that Dodd-Frank not only fails to meaningfully address, but in fact fails to address at all—the standardized residential mortgage. While the Act changed the way lenders originate loans and how they underwrite them, including how related derivatives are sold and traded, it did not address this all important component of the mortgage credit system.<sup>217</sup> In fact, the mortgage contract has remained little changed since it was first formulated in 1971—almost half a century ago.<sup>218</sup> However, the housing market has indeed changed, and changed greatly. The way would-be homeowners engage in the home loan process is vastly different today than when the standard mortgage contract was first developed.<sup>219</sup> Indeed, there were many involved in that early process who understood the significance of contract harmonization and the impact it would have on the way housing credit works for most Americans.<sup>220</sup> One such notable individual was Senator Ralph Nader who took part in the hearings that gave rise to the standardization mortgage and the secondary market.<sup>221</sup> He stated in testimony before the congressional committee: “What is now a face-to-face relationship between two people in the same locality will become an impersonal relationship through agents between a person and a bulk buyer of investment paper.”<sup>222</sup> How right he was and how prophetic were his words. Yet, despite Dodd-Frank’s vast scope and significance in terms of its reshaping of the American financial landscape, this all-important document was not touched.<sup>223</sup>

An appraisal of the standardized residential mortgage is part of the unfinished business of Dodd-Frank. It has been 45 years since its inception. It is time for lawmakers, housing advocates, policy experts, and the American public to revisit this central link to the housing economy and the defining document for homeownership in this country.

#### A. RECENT ABUSE OF MORTGAGE CONTRACT TERMS

While it is interesting to note the absence of any real attention paid to the mortgage contract in the wake of the financial and housing crash, one might argue that it is not altogether surprising. It was the issuance of subprime loans, the false rating of the securitization of those loans, and the overall economics underlying the housing system that brought about the crash—not the actual terms of the mortgage contract.<sup>224</sup> From this perspective, one might think that perhaps the mortgage contract need not be changed, and so its omission from the Dodd-Frank Act was foreseeable

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217. See generally *CFR Backgrounders*, *supra* note 212.

218. See *supra* Part I.B-C and accompanying discussion.

219. See *supra* Part I.B-C.

220. Carrozzo, *supra* note 58, at 797–98.

221. *Id.* at 799–800.

222. *Id.* at 798–99 (citing *Federal National Mortgage Association Public Meeting on Conventional Mortgage Forms: Hearing Before the S. Comm. on Banking, Hous., and Urban Affairs*, S. Doc. No. 92-21, 92nd Cong., 1st Sess. 100 (1971)).

223. See *id.*

224. See Dibadj, *supra* note 148, at 94.

and indeed justified. However, that view would be short-sighted and fails to recognize the significant role that the mortgage contract has played and continues to play in the fall-out from the crisis. In fact, a not-so-small scandal emerged over the past few years in connection with the ways in which banks, and specifically their third party contractors, utilized the rights granted to them under the mortgage contract.<sup>225</sup> This series of abusive practices has become known as the break-in foreclosure scandal.<sup>226</sup>

This scandal arose from the aftermath of the housing crisis, where banks were confronted with an enormous number of properties awaiting foreclosure.<sup>227</sup> Many of these properties could not even be sold at a foreclosure sale due to their markedly decreased values.<sup>228</sup> To aide them in handling this crisis, banks began to increasingly use third party contractors—commonly called the mortgage field services industry—to help them in managing these foreclosed or soon-to-be-foreclosed properties.<sup>229</sup> These companies claimed expertise in the management and preservation of real property and, as part of their arrangement with the banks, would take charge of large numbers of distressed properties with a view toward ensuring that they were being preserved and properly maintained.<sup>230</sup> The most recognizable of these property preservation contractors is Safeguard Properties, which has been the subject of most of the litigation involving these alleged break-in foreclosure practices.<sup>231</sup>

These property management firms were charged with going to the mortgaged property, inspecting the premises from the street without entering on to the property, and determining whether the property was still occupied or if it had been abandoned by the distressed homeowner.<sup>232</sup> If it was determined, in good faith, that the property was abandoned, then the contractor was charged with securing the premises by “boarding up the doorway, turning off the water and winterizing the home, and placing lockboxes or padlocks on the doors.”<sup>233</sup> These acts sometimes even involved removing furnishings and other personal effects from the home.<sup>234</sup> Moreover, the provision of these services often continued “throughout the foreclosure process and after the mortgage lender purchase[d] the property in the foreclosure auction.”<sup>235</sup>

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225. See Odinet, *supra* note 16, at 1161.

226. *Id.* at 1162.

227. See *id.* at 1160–61, 1179.

228. See *id.* at 1179.

229. *Id.*; see also Jessica Silver-Greenberg, *Invasive Tactic in Foreclosures Draws Scrutiny*, N.Y. TIMES (Sept. 9, 2013, 8:23 PM), <http://dealbook.nytimes.com/2013/09/09/invasive-tactic-in-foreclosures-draws-scrutiny> [<https://perma.cc/Q7HQ-ZH3Z>].

230. Odinet, *supra* note 16, at 1179.

231. See *id.* at 1159–62.

232. Ben Hallman, *Banks Keep Breaking Into Houses, and Homeowners Are Fighting Back*, HUFFINGTON POST (Oct. 3, 2013), [http://www.huffingtonpost.com/2013/10/02/bank-contractor-lawsuits-safeguard\\_n\\_3975574.html](http://www.huffingtonpost.com/2013/10/02/bank-contractor-lawsuits-safeguard_n_3975574.html) [<https://perma.cc/5Q2M-CJPV>].

233. Complaint at ¶ 34, *Illinois v. Safeguard Properties, L.L.C.*, No. 2013-Ch-20175, 2013 WL 5290237 (Ill. Cir. Ct. Sept. 9, 2013).

234. *Id.* at ¶ 51.

235. *Id.* at ¶ 35.

The authority for the lender's right to inspect and engage in acts of preservation as it relates to the property is derived from a standard provision in the Fannie Mae/Freddie Mac mortgage.<sup>236</sup> This clause is quite broad, far-reaching, and states that if the homeowner intentionally or negligently allows the mortgaged property to become damaged or to deteriorate, then the lender or its representative has the power to enter onto the premises and remediate.<sup>237</sup> Unfortunately, however, there have been many cases where these clauses were not used in good faith.<sup>238</sup> Instead, allegations abound that mortgage servicers, through their property contractors, engaged in much more aggressive and, in many cases, unauthorized activities when dealing with these foreclosed properties.<sup>239</sup> In fact, many reports indicate that the determination of occupancy was a mere pretext for intimidating the homeowner, in addition to reports of the destruction of personal property, and not to mention the inevitable feelings of shame and violation that occur as a result of a home break-in.<sup>240</sup>

In one report out of Tampa, Florida, a homeowner named Deanna Tedone stated that she returned home one day to find that a contractor, sent by her lender U.S. Bank, was smashing holes in the walls of her house.<sup>241</sup> His stated reason for his activities was that he was inspecting the property for Chinese-drywall on behalf of U.S. Bank, which was seeking to protect its collateral.<sup>242</sup> Tedone noted that she had indeed fallen behind on her mortgage obligations, but neither her bank nor its agent had contacted her prior to the inspection.<sup>243</sup> In the end, the inspector's work left debris and rubble scattered about the home.<sup>244</sup>

In another report, an Illinois homeowner named Majorie Principe alleged that she returned home one day to discover that her mortgagee's contractor had "taken her furniture, books, savings bonds and electronics."<sup>245</sup> Another homeowner in Cleveland, Ohio, claimed to have been robbed of his clothing by a property preservation sweep, and an Atlanta man was actually arrested when he "forced his way back into his home after a Safeguard contractor locked him out."<sup>246</sup> In the end, it was discov-

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236. See Odinet, *supra* note 16, at 1183.

237. *Id.*

238. See Silver-Greenberg, *supra* note 229; see also Odinet, *supra* note 16, at 1184–85.

239. Jeff Rossen & Avni Patel, *Home Break-ins: Bank Contractors Accused of Cleaning Out Wrong Homes*, TODAY NEWS (Oct. 2, 2013, 6:46 AM), <http://www.today.com/news/home-break-ins-bank-contractors-accused-cleaning-out-wrong-homes-8C11296802> [<https://perma.cc/R5QP-HZN3>]; Chris Morran, *Homeowners Win Lawsuit Over Fraudulent Foreclosure But May Still Lose House*, CONSUMERIST (Nov. 1, 2012), <http://consumerist.com/2012/11/01/homeowners-win-lawsuit-over-fraudulent-foreclosure-but-may-still-lose-house/> [<https://perma.cc/F29W-68VR>].

240. See generally Hallman, *supra* note 232.

241. *Id.*

242. *Id.*

243. *Id.*

244. *Id.*

245. *Id.*

246. See generally Hallman, *supra* note 232.

ered that the contractor had actually gone to the wrong house!<sup>247</sup>

Even tenants have been victims. A Missouri woman named Nicole Corum stated that she came home one evening to discover her home greatly damaged and all of her belongings missing, including her 7-year old son's toys.<sup>248</sup> Neighbors reported seeing a worker emptying the house earlier in the day and, when challenged, the worker stated "I work for Safeguard deal with them."<sup>249</sup> When Corum contacted Safeguard, she reported that they told her that all her things were "out in the dump" and that the company was not in the business of keeping things resulting from a preservation inspection in storage.<sup>250</sup>

These stories have continued even into 2015,<sup>251</sup> which is not surprising considering the lack of any real regulation of the mortgage field services industry and little industry standards regarding the use of contractors by banks.<sup>252</sup> "Over the past several years since the outbreak of the housing foreclosure crisis over two hundred fifty lawsuits have been filed against various property preservation firms, and these cases span across thirty-one states."<sup>253</sup> In fact, in 2013, the attorney general of Illinois filed a lawsuit against Safeguard Properties in connection with a long string of successive break-in-style foreclosure actions spanning across that state based on the state's consumer fraud act.<sup>254</sup> And all of these stories stem from one single clause found in the standard mortgage contract. As Senator Ralph Nader noted in the committee hearings in the 1970s, the standard residential mortgage granted too much power to lenders, specifically "the power to invade the consumer's home for any reason, or no reason at

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247. *Id.*

248. See Heather Catallo, *Some Homeowners in Foreclosure Lose Belongings after Company Clears Out Their Houses Too Soon* (May 15, 2013, 7:54 AM), <http://www.wxyz.com/news/local-news/investigations/some-homeowners-in-foreclosure-lose-belongings-after-company-clears-out-their-houses-too-soon> [<https://perma.cc/QYR3-VF2R>].

249. *Id.*

250. *Id.* Ms. Corum and two other families who experienced similar treatment at the hands of this bank contractor have filed suit against Safeguard. See *id.* The attorney representing the plaintiffs stated, "Imagine having your family heirlooms . . . something you want to hand down to your children or whatever . . . and all of a sudden one day all of that is snatched from you." *Id.*

251. See Jennifer Walpole, *Filmmaker Investigates Wrongful Foreclosures and Hits a Nerve*, THE REAL DAILY (April 30, 2015), <https://therealdaily.com/politics/foreclosure-hell-paradise-wells-fargo-responds-media-inquiries/> [<https://perma.cc/ND83-KBRZ>]; Jon Humbert, *Lawsuits: 'Trash Out' Company Empties Homes Illegally*, KOMONews.COM (April 29, 2015), <http://komonews.com/archive/lawsuits-trash-out-company-empties-homes-illegally> [<https://perma.cc/NQU8-KJFM>]; Chris Ingalls, *Bank 'Break-ins' Show Need to Update WA Foreclosure Law*, KING 5 NEWS (Mar. 3, 2015), <http://www.king5.com/story/news/local/investigations/2015/03/02/banks-default-home-owners-lock-outs/24290199/>; Dena Aubin, *Judge seeks state court input in Nationstar trespass lawsuit*, REUTERS (Aug. 14, 2015), <http://www.reuters.com/article/nationstar-trespass-idUSL1N10P0F320150814> [<https://perma.cc/GZR6-NVSS>].

252. See Odinet, *supra* note 16, at 1206 (discussing the lack of any real regulation of the mortgage field servicing industry and recommending the adoption of such a structure).

253. *Id.* at 1186. "Although many of the suits have occurred during the past two years, some of the earliest break-in style foreclosures occurred as far back as 2010." *Id.* at 1185, n. 233.

254. See Complaint, *supra* 235, at ¶ 152.



all.”<sup>255</sup> Indeed, his prophetic words have come true as the break-in foreclosure crisis continues to this day to infect the housing recovery.<sup>256</sup>

#### B. REFORM IN THE PRIVATE LABEL RMBS MARKET

Aside from break-in foreclosure abuses and the simple lapse of time since there has been any meaningful review of the Fannie Mae/Freddie Mac mortgage, there is yet another significant reason why a reappraisal is more important now than ever: the private label mortgage securities market is undertaking its own independent efforts to create mortgage contract standardization.<sup>257</sup>

The private label mortgage sector is a financial marketplace for the buying and selling of mortgage loans that do not meet the requirements necessary for purchase by the GSEs, known as “non-conforming loans.”<sup>258</sup> Because they lack conforming features, they are not eligible for a government guarantee of insurance and therefore are significantly riskier than their conforming cousin loans.<sup>259</sup> Such loans usually are made to borrowers with very low credit scores, have negative amortization schedules, and are given with little documentation (low-doc) or with a very high loan amount (jumbo loans).<sup>260</sup> The appeal to investors who purchase non-conforming loans on the private label market is the possibility of high returns.<sup>261</sup> In order to gauge the amount of risk of these products, investors resorted to using ratings agencies from the past.<sup>262</sup> Unfortunately for these investors, the ratings agencies grossly over rated these investments leading up to 2008, and when the housing bubble crashed, investors took heavy losses.<sup>263</sup> Since then, some private label commercial mortgage-backed securities have seen an uptick in activity, but the residential private label mortgage-backed securities market basically remains dead.<sup>264</sup>

However, a financial trade association called the Structured Finance Industry Group, which is “focused on improving and strengthening the broader structured finance and securitization market” recently launched efforts to re-invigorate the private label market for residential mortgage-

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255. See Carrozzo, *supra* note 58, at 799.

256. See Odinet, *supra* note 16, at 1212–13.

257. See Structured Finance Industry Group, *RMBS 3.0—A Comprehensive Set of Proposed Industry Standards to Promote Growth in the Private Label Securities Market* (6 Aug 2014), [http://www.sfindustry.org/images/uploads/pdfs/RMBS\\_3.0\\_Second\\_Edition\\_Green\\_Papers.pdf](http://www.sfindustry.org/images/uploads/pdfs/RMBS_3.0_Second_Edition_Green_Papers.pdf) [<https://perma.cc/J5SN-RTGU>] [hereinafter *RMBS 3.0*].

258. See Laura Goodman, *The Rebirth of Securitization: Where Is the Private-Label Mortgage Market?*, URBAN INST. 1–2 (Sept. 10, 2015), [http://www.urban.org/research/publication/rebirth-securitization-where-private-label-mortgage-market/view/full\\_report](http://www.urban.org/research/publication/rebirth-securitization-where-private-label-mortgage-market/view/full_report) [<https://perma.cc/MG2P-67GP>].

259. *Id.* at 1.

260. *See id.* at 6.

261. *See id.* at 1.

262. *See id.* at 6–7.

263. *See id.*

264. Goodman, *supra* note 258 at 1.

backed securities (RMBS).<sup>265</sup> The report notes that in order for the RMBS market to move beyond the shock of the housing crisis, “members must tackle the difficult but critical task of creating standardized representations, warranties, and repurchase enforcement mechanisms” that are so critical to the effective operations of this market.<sup>266</sup> Indeed, the private label securities market appears to be on the verge of doing exactly what Congress and the GSEs did in the 1970s—creating standardization in RMBS transactions, but this time in the private label market.<sup>267</sup>

The report notes that, much like prior to the standard Fannie Mae/Freddie Mac mortgage, in the RMBS market, “divergence among the various approaches has significantly influenced rating agency decisions and limited investor participation.”<sup>268</sup> Standardization, at least to some significant extent, is essential in creating a robust secondary market for private label mortgage securities backed by residential property.<sup>269</sup> The industry model standards outlined in the report make suggestions on streamlining representations and warranties dealing with fraud,<sup>270</sup> regulatory and consumer protection compliance,<sup>271</sup> no encroachments and zoning compliance,<sup>272</sup> and disclosure of loan underwriting guidelines, among many others.<sup>273</sup>

The model provisions discussed above admittedly do little directly in the way of residential borrowers. Instead, they address the variance in the forms and contracts used between issuers and investors in the RMBS private label market.<sup>274</sup> The Fannie Mae/Freddie Mac uniform mortgage, on the other hand, is the link between the originator/future holders and the borrower, therefore, its provisions are of great importance.<sup>275</sup> Nevertheless, there is significance in the RMBS industry’s recent efforts. They are preparing for a resurgence in the RMBS market and, as such, are laying

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265. See RMBS 3.0, *supra* note 257, at n.1.

266. *Id.* at 1.

267. *Id.* (“Most industry participants seem to believe that, without a targeted effort at establishing generally accepted best practices, the RMBS market will continue to reflect disparate standards.”).

268. *Id.* at 1.

269. See *id.* at 2.

270. See *id.* at 17 (“Many market participants have noted their position that the substantial variation in fraud representations made it difficult for them to assess the issues covered within a transaction and from deal to deal. Additionally, in some securitizations, no fraud representation was made by certain parties. This system created a lack of standardization in the market which continues today, albeit to a lesser extent, largely due to limited market volume and a limited number of post-crisis issuers and RMBS transactions.”).

271. See RMBS 3.0, *supra* note 257, at 23.

272. See *id.* at 37 (“Many market participants have noted their position that the substantial variation in no encroachment representations made it difficult for them to assess the issues covered within a transaction and from deal to deal.”).

273. See *id.* at 63 (“Participants believe that providing greater transparency through the underwriting guideline disclosure would aid investor understanding of the guidelines and allow investors to compare guidelines more effectively, both within a transaction and across transactions.”).

274. See *id.* at 1.

275. See *supra* Part I.

the ground-work for a market-wide contractual framework that contemplates fairer terms, more even-handed representations and warranties, and more acceptable disclosures.<sup>276</sup> In other words, there is an effort to bring the private label market players together to work out how the post-financial crisis RMBS market will operate.<sup>277</sup>

Dodd-Frank was the post-financial crisis workout for much of the financial industry.<sup>278</sup> However, it did not go through the same exercise of reevaluating the Fannie Mae/Freddie Mac uniform residential mortgage contract. As the data above indicates, the vast majority of new residential mortgage loan originations are conforming loans (indeed, there is little if any activity at all in the RMBS market) coming in the form of qualified mortgages (i.e., those with quite strict underwriting).<sup>279</sup> Why then has there not been a discussion of the mortgage contract in the context of the GSE-dominated secondary market? If the RMBS industry is getting its house in order and reevaluating the terms that govern some of their most important legal relationships, then so too should the GSEs when it comes to the standardized residential mortgage.<sup>280</sup> If the financial crisis taught us nothing else, it was how dangerous it can be to leave the private sector to its own devices in an area so tied to government participation and so important to public life and society as the financing of homeownership.

### C. RECOMMENDATIONS FOR REFORM

In light of these factors, the time has come for the GSEs, housing advocates, and industry players to undertake a serious and informed review of the standard residential mortgage—a document now nearly fifty years old.<sup>281</sup> A fresh look is warranted for a number of compelling reasons. First, today's home loan borrowers are made to undergo a more stringent and scrutinizing underwriting process than ever before.<sup>282</sup> Indeed, today only the most credit worthy of borrowers can become homeowners.<sup>283</sup> Recent industry data shows that mortgage originators are nearly 100% of the time issuing only qualified mortgage loans to new homeowners. With such a change in the way loans are made on the frontend, a more tempered mortgage contract is merited.

Second, at least some of the provisions in the standard mortgage contract—mainly the property preservation clause—have been at the heart of a recent, nation-wide foreclosure scandal.<sup>284</sup> The break-in foreclosure activity that has cropped up across the country has been on the front page of many major newspapers and has spurred litigation in a majority of the

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276. See generally RMBS 3.0, *supra* note 257, at 1–4.

277. *Id.*

278. *Supra* Part II.B.

279. See *supra* Part II.C and accompanying chart.

280. See generally RMBS 3.0, *supra* note 257, at 1.

281. See Goodman, *supra* note 258, at 1.

282. *Id.* at 6.

283. *Id.*

284. Odinet, *supra* note 16, at 1161.

states.<sup>285</sup> Even the Office of the Inspector General of the Department of Housing and Urban Development has taken note of these abuses and the fact that there is almost no regulation of property contractors used by banks in the foreclosure crisis.<sup>286</sup> While reforming the mortgage contract would not systemically change the mortgage field services industry, it does have the potential to diminish the chances for abuse by getting to the source of the bank's authority to deal with the mortgaged properties prior to foreclosure.<sup>287</sup> A change in the property preservation provision of the standard mortgage contract could help mitigate future scandals of this type.

Lastly, the reform activities currently underway in the private label mortgage market, specifically with RMBS transactions, should serve as an impetus for GSE secondary market leaders to also reevaluate their current practices and standardized forms. As the private label market looks to harmonize their contracts and processes so as to balance the interests of issuers and investors, so too should Fannie, Freddie, and related interest holders look to reevaluate their processes—specifically through the lens of the mortgage contract—to ensure that fairness, equity, and modernized best practices remain at the forefront of the home loan process.

The following discussion focuses on three provisions found in the standard residential mortgage contract that might serve as a starting point for such discussions. Although there are arguments to advance on all sides regarding whether these provisions should be kept, reformed, or scrapped altogether, this article hopes to begin a discussion of what reforms might be possible in order to better balance the rights of homeowners and mortgage lenders.

### 1. *Creditor's Unilateral Right of Entry*

The first provision is perhaps the most egregious because it allows the lender to unilaterally enter the property of the homeowner for the vague purpose of making an “inspection.”<sup>288</sup> The only limitation of this right is that the inspection must be reasonable in time and manner.<sup>289</sup> Importantly, there is no requirement that the lender actually notify the homeowner that such an inspection will take place.<sup>290</sup> Regardless of the fact that the borrower is current on his monthly payments and otherwise in conformity with other obligations under the loan, in the event the lender decides an inspection is needed, it may send its agents to physically come

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285. *Id.* at 1168.

286. *See* FED. HOUSING FIN. AGENCY, AUDIT REP. NO. 2014-012, FHFA OVERSIGHT ENTERPRISE CONTROLS OVER PRE-FORECLOSURE PROPERTY INSPECTIONS 2 (2014), <https://origin.www.fhfaog.gov/Content/Files/AUD-2014-012.pdf> [<https://perma.cc/APV3-Q56D>].

287. *See id.* at 3.

288. NEW YORK—SINGLE FAMILY—FANNIE MAE/FREDDIE MAC NEW YORK UNIFORM INSTRUMENT, FORM 3033 § 7(B), p. 9, <http://www.freddiemac.com/uniform/doc/3033-NewYorkMortgage.doc> [<https://perma.cc/E9E6-YQBJ>] [hereinafter N.Y. MORTGAGE].

289. *Id.*

290. *See id.*

on to the property and conduct the examination.<sup>291</sup> The following provision describes the right:

Lender's Inspection of Property. Lender, and others authorized by Lender, may enter on and inspect the Property. They will do so in a reasonable manner and at reasonable times. If it has a reasonable purpose, Lender may inspect the inside of the home or other improvements on the Property. Before or at the time an inspection is made, Lender will give me notice stating a reasonable purpose for such interior inspection.<sup>292</sup>

What would perhaps shock most homeowners is the second part of this clause—that the lender also has the ability to inspect the inside of the home and other improvements on the property.<sup>293</sup> The thought that the lender, without being prompted by a default or other failure to abide by the terms of the mortgage, has the unilateral right to enter a one's home, garage, or other improvement would, and should, shock most homeowners. However, the clause does provide that the homeowner must be provided notice of such an "interior inspection," but the provision gives no minimum time frame for such notice.<sup>294</sup> Rather, the notice can even be made "at the time an inspection is made" which is tantamount to no notice at all.<sup>295</sup> Additionally, the provision does not provide how long before the inspection the notice must be given, rather it merely must be beforehand, at some point.<sup>296</sup> Can it be the same day or a mere few hours? The mortgage does not give an answer.<sup>297</sup> Rather, the provision is geared entirely in favor of the lender and is at its discretion.

The unspoken truth behind this clause is the notion that the borrower cannot be trusted with the home. In other words, the lender should have the right to inspect the property at will because the borrower surely cannot be relied upon to maintain the property and keep it in good repair.<sup>298</sup> Thrown to the wind is the notion that the property serves as the dwelling place and abode of the borrower—a concept that is given great policy and legal weight under various provisions of American law.

Therefore, this provision should be eliminated entirely. Absent some breach on behalf of the borrower—whether in monthly payments or other obligations in the mortgage—the lender should not have the ability to interfere with the possessory rights of the homeowner. If borrowers are required to meet such rigorous underwriting criteria on the front end, then provisions like these that assume the worst about the borrower (i.e., that she would have no care or reliable reason to keep her property in good repair) are unjust and offensive. Moreover, while the lender cer-

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291. *See id.*

292. *Id.*

293. *Id.*

294. *See* N.Y. MORTGAGE, *supra* note 288.

295. *Id.*

296. *See id.*

297. *See id.*

298. *See id.*

tainly has an interest in assuring that his collateral is maintained, collateral that constitutes a home is due treatment different from collateral on a commercial property. The status of the property as the dwelling place of the individual merits different treatment and a heightened level of respect.

## 2. Debtor's Mandatory Escrow Requirements

The next provision deals with the borrower's obligation to escrow various payments with the lender that are ancillary to the obligation to repay the loan itself.<sup>299</sup> Naturally, the borrower must make monthly payments of principal and interest in accordance with the loan's payment schedule. But the borrower's obligations under this provision go far beyond that.<sup>300</sup> He must make monthly advances to his lender in amounts necessary to pay for property taxes, any municipal or other assessments, utility charges for sewer and water, property and flood insurance, and even neighborhood association dues.<sup>301</sup>

Moreover, the lender need not require such payments from the start.<sup>302</sup> Rather, at any point during the term of the loan the lender may decide to include these sundry expenses as part of the borrower's monthly payment obligations.<sup>303</sup> And importantly, the lender is the one with the authority to set the estimates that determine the amount of the monthly payments.<sup>304</sup> Although it is true that the lender is limited by various federal laws and regulations, such as the Real Estate Settlement Procsures Act,<sup>305</sup> from holding large amounts in escrow, the power is still very much in the hands of the lender in making these determinations and any adjustments over time.<sup>306</sup> The following provision describes the escrow requirements of the borrower:

### Monthly Payments For Taxes And Insurance.

(a) Borrower's Obligations. I will pay to Lender all amounts necessary to pay for taxes, assessments, water charges, sewer rents and other similar charges, ground leasehold payments or rents (if any), hazard or property insurance covering the Property, flood insurance (if any), and any required Mortgage Insurance, or a Loss Reserve as described in Section 10 in the place of Mortgage Insurance. Each Periodic Payment will include an amount to be applied toward payment of the following items which are called "Escrow Items:"

(1) The taxes, assessments, water charges, sewer rents and other similar charges, on the Property which under Applicable Law may be superior to this Security Instrument as a Lien on the Property. Any claim, demand or charge that is made against

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299. *See id.* at 5.

300. *See* N.Y. MORTGAGE, *supra* note 288.

301. *See id.*

302. *See id.*

303. *See id.*

304. *See id.*

305. 12 U.S.C. § 2609(a) (2011).

306. N.Y. Mortgage, *supra* note 290, at 5.

property because an obligation has not been fulfilled is known as a “Lien;”

(2) The leasehold payments or ground rents on the Property (if any);

(3) The premium for any and all insurance required by Lender under Section 5 of this Security Instrument;

(4) The premium for Mortgage Insurance (if any);

(5) The amount I may be required to pay Lender under Section 10 of this Security Instrument instead of the payment of the premium for Mortgage Insurance (if any); and

(6) If required by Lender, the amount for any Community Association Dues, Fees, and Assessments.

After signing the Note, or at any time during its term, Lender may include these amounts as Escrow Items. The monthly payment I will make for Escrow Items will be based on Lender’s estimate of the annual amount required.<sup>307</sup>

It is worth noting that federal law has dealt with escrow requirements both before and after Dodd-Frank. For instance, many FHA loans have mandatory escrow requirements.<sup>308</sup> Also, Regulation Z, which interprets the Truth in Lending Act, requires lenders to establish escrow accounts for certain high-priced residential mortgage loans.<sup>309</sup> However, many of these rules only require a one-year escrow period. The CFPB issued a rule in January 2013 that modified the Regulation Z requirement in two ways.<sup>310</sup> First, it extended that time period from one to five years.<sup>311</sup> Second, it exempted certain mortgage loans from the escrow requirement—those in rural areas, made to underserved communities, and those made by small volume or low-asset mortgage lenders.<sup>312</sup> Otherwise, it is up to the lender to decide whether to escrow certain amounts. And, as the provision above indicates, nearly all residential lenders do so.<sup>313</sup>

However, if the mortgage borrowers of today are required to show a certain level of financial sophistication in the way of their credit-worthiness—evidence one might persuasively argue is indicative of an ability to manage one’s own money and financial obligations effectively—then the need for escrow requirements seems overly burdensome and heavy-handed. For instance, a homeowner might have valid financial reasons for wanting, for instance, to make lump sum payments of certain charges when they come due, rather than paying in monthly installments into an

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307. *Id.* at 5–6.

308. See U.S. DEP’T OF HOUSING & URBAN DEV., GUIDANCE FOR HOMEOWNERS, [http://portal.hud.gov/hudportal/HUD?src=/program\\_offices/housing/sfh/owning#4](http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/owning#4) [https://perma.cc/LW63-BDF7].

309. 12 C.F.R. § 226.18(s)(3)(ii).

310. See *id.*

311. FED. REG., ESCROW REQUIREMENTS UNDER THE TRUTH IN LENDING ACT (REGULATION Z) § 1026.35 (Jan. 22, 2013), <https://www.federalregister.gov/articles/2013/01/22/2013-00734/escrow-requirements-under-the-truth-in-lending-act-regulation-z#h-19> [https://perma.cc/Q4PB-JX3E].

312. See *id.*

313. N.Y. MORTGAGE, *supra* note 288, at 5.

escrow account. Having access to significant portions of capital for emergencies and being able to save and plan or prepare for large expenses is representative of good financial management. Hence, if the borrower must essentially show that he has these skills during the underwriting review period, then he should similarly be accorded the benefit of doing the same with his periodic charges thereafter.

That is not to say that some or even many borrowers may not still desire to avail themselves of escrow arrangements with their lenders. Indeed, the convenience is attractive since the borrower need only pay the set amount each month and thereafter not worry about whether various charges (property taxes, insurance, etc.) are paid. But on the other hand, there are likely some borrowers who would like to control and have access to those amounts that would otherwise be escrowed. They might rather plan accordingly to make proper payments at the time they are due. Therefore, borrowers should have the choice as to whether to escrow certain amounts, thereby giving some autonomy to the borrower, while still maintaining the convenience that escrow arrangements can provide.

### 3. *Creditor's Expansive Rights Upon Default*

Last, but not least, are the provisions of the mortgage contract that speak to the rights of the lender upon a default or other failure to comply on the part of the borrower.<sup>314</sup> Unlike the other provisions discussed above that apply regardless of a default, the clauses shown below are designed to shift the power and control between the parties as it pertains to the property itself, once the nature of the relationship between the borrower and the lender become directly adverse.<sup>315</sup> Indeed, the most obvious example of such a change in position is a monetary default by the borrower (i.e., a missed monthly payment).

However, as indicated below, the rights that spring to life in favor of the lender under these clauses do not merely hinge on a monetary default.<sup>316</sup> Rather, the language is more broadly drafted to include the violation of any and all “promises and agreements” and includes triggers, such as the filing of a petition in bankruptcy, the mere pendency of proceedings by third parties claiming an interest in the property on par or exceeding the lender’s mortgage, or proceedings for the enforcement of municipal liens.<sup>317</sup> Abandonment of the property, regardless of the timeliness of payments or other obligations, also triggers these rights.<sup>318</sup> If there is any such failure, a default occurs, and a host of rights—many of which are extremely aggressive and overreaching—become available to the lender:

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314. *See id.* at 10.

315. *See id.*

316. *See id.*

317. *See id.*

318. *See* N.Y. MORTGAGE, *supra* note 288, at 10.



Lender's Right to Protect Its Rights in The Property. If: (a) I do not keep my promises and agreements made in this Security Instrument; (b) someone, including me, begins a legal proceeding that may significantly affect Lender's interest in the Property or rights under this Security Instrument (such as a legal proceeding in bankruptcy, in probate, for Condemnation or Forfeiture (as defined in Section 11), proceedings which could give a Person rights which could equal or exceed Lender's interest in the Property or under this Security Instrument, proceedings for enforcement of a Lien which may become superior to this Security Instrument, or to enforce laws or regulations); or (c) I have abandoned the Property, then Lender may do and pay for whatever is reasonable or appropriate to protect Lender's interest in the Property and Lender's rights under this Security Instrument.

Lender's actions may include, but are not limited to: (a) protecting and/or assessing the value of the Property; (b) securing and/or repairing the Property; (c) paying sums to eliminate any Lien against the Property that may be equal or superior to this Security Instrument; (d) appearing in court; and (e) paying reasonable attorneys' fees to protect its interest in the Property and/or rights under this Security Instrument, including its secured position in a bankruptcy proceeding. Lender can also enter the Property to make repairs, change locks, replace or board up doors and windows, drain water from pipes, eliminate building or other code violations or dangerous conditions, have utilities turned on or off, and take any other action to secure the Property. Although Lender may take action under this Section 9, Lender does not have to do so and is under no duty to do so. I agree that Lender will not be liable for not taking any or all actions under this Section 9.<sup>319</sup>

Such broad contractual authority includes the power to "do and pay for whatever is reasonable and appropriate to protect the Lender's interest in the Property," which leaves much to the creditor's discretion.<sup>320</sup> Conveniently, the provision provides an illustrative list of such "reasonable" acts—lest one think such authority is limited—which include the vague power to "protect" the value of the asset and secure and repair the property.<sup>321</sup> Interestingly, the duty to give notice before entering the premises is dispensed with, as the clause allows the lender to enter and change locks, board up windows, turn off the utilities, and "take any other action" to secure the property.<sup>322</sup> Indeed, what broader authority could a lender desire? And notably all of this power devolves to the lender prior to any foreclosure proceedings.<sup>323</sup>

The triggering of this clause, which according to the language of the mortgage could be caused by the most innocuous of offenses, essentially

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319. *Id.*

320. *Id.*

321. *Id.*

322. *Id.*

323. *See id.*

amounts to a forfeiture of the borrower's possessory rights in the property.<sup>324</sup> It is worth remembering that this is not merely any random property of the borrower. Rather, this is his home, his dwelling, his abode. It is the place his family resides, where he seeks sanctuary, and where he shares the most intimate moments of life. This immediate, harsh, and relatively unpredictable bundle of rights in favor of the lender is troublesome.

While a lender surely must be vested with the tools it needs to preserve its collateral in the event of a default, the scope and potency of the rights described in this clause go too far.<sup>325</sup> Such provisions should be narrowly tailored to identify the trigger of the aforementioned powers. Those powers should be limited to only the most severe kinds of defaults after proper notice is given. Lenders must take into account the human element—the violative nature of intrusion upon one's home.

### CONCLUSION

Much remains to be explored and written in the ever-changing world of mortgage lending. The credit box remains small, and the opportunities for many Americans, particularly for blacks, Hispanics, and low-income groups, remain few and far between.<sup>326</sup> Moreover, with Fannie Mae and Freddie Mac under what appears to be a perpetual conservatorship (which includes frequent capital sweeps from the Treasury Department of their reserves<sup>327</sup>), the secondary market is anything but settled.<sup>328</sup> What is certain is that we will see a continued evolution in mortgage credit in the United States, which will hopefully be driven by the goals of consumer protection, safety and soundness, and access to credit and homeownership.

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324. See N.Y. MORTGAGE, *supra* note 288.

325. See *id.* at 5–6, 9–10.

326. James H. Carr, *Outdated Credit Scoring Models Shut Minorities Out of Housing Market*, FORBES (April 9, 2015, 4:41 PM), <http://www.forbes.com/sites/janetnovack/2015/04/09/outdated-credit-scoring-models-shut-minorities-out-of-housing-market/#1ca09f8c6382> [https://perma.cc/88DD-5J3T]; LAURA SULLIVAN ET AL., INST. FOR ASSETS & SOC. POL'Y, BRANDEIS UNIV., *THE RACIAL WEALTH GAP: WHY POLICY MATTERS* 1 (2015), <http://iasp.brandeis.edu/pdfs/2015/RWA.pdf> [https://perma.cc/PW5P-PQMF]; LAURIE GOODMAN, JUN ZHU & TAZ GEORGE, *WHERE HAVE ALL THE LOANS GONE? THE IMPACT OF CREDIT AVAILABILITY ON MORTGAGE VOLUME*, URBAN INSTIT. 1 (2014), <http://www.urban.org/sites/default/files/alfresco/publication-pdfs/413052-Where-Have-All-the-Loans-Gone-The-Impact-of-Credit-Availability-on-Mortgage-Volume.pdf> [https://perma.cc/F8ET-8XBD].

327. Clea Benson & Jody Shenn, *Fannie-Freddie Profit Sweep Defended by Key Treasury Adviser*, BLOOMBERG (Mar. 5, 2015, 10:33 AM), <http://www.bloomberg.com/news/articles/2015-03-05/fannie-freddie-profit-sweep-defended-as-treasury-seeks-wind-down> [https://perma.cc/8PMG-T7AB].

328. Gretchen Morgenson, *A Revolving Door Helps Big Banks' Quiet Campaign to Muscle Out Fannie and Freddie*, N.Y. TIMES (Dec. 7, 2015), [http://www.nytimes.com/2015/12/07/business/a-revolving-door-helps-big-banks-quiet-campaign-to-muscle-out-fannie-and-freddie.html?\\_r=0](http://www.nytimes.com/2015/12/07/business/a-revolving-door-helps-big-banks-quiet-campaign-to-muscle-out-fannie-and-freddie.html?_r=0) [https://perma.cc/XTG5-ETVU]; Jim Parrott & Mark Zandi, *Fixing Fannie and Freddie for Good*, N.Y. TIMES (Dec. 15, 2015), <http://www.nytimes.com/2015/12/15/opinion/fixing-fannie-and-freddie-for-good.html> [https://perma.cc/P3JS-UXGL].

As we continue to have these public discussions about Dodd-Frank and the regulation of mortgage lending more broadly, this Article argues that we should also consider the importance of including in these conversations a reappraisal of the Fannie Mae/Freddie Mac standard mortgage. In many ways this document does not reflect the current state of consumer credit relations when it comes to housing. Several of its provisions are overreaching, have been abused, and represent a mistrustful view of homeowners. This document is fundamental and deserves a careful review and input from the public. Indeed, it is the unfinished business of mortgage lending reform, and because it lies at the heart of homeownership in America, it is certainly worthy of a second look.